United States Court of Appeals

for the Second Circuit

JOINT APPENDIX

76-7278

Volume A-6
Page A-211 (1827) to A-211 (2188)

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 76-7278

B

MARGARET MARY MCDONNELL MURPHY,
Plaintiff-Appellant,

against

MCDONNELL & CO., INCORPORATED and THE NEW YORK STOCK EXCHANGE by ROBERT W. HAACK, President,
Defendants.

JAMES F. MCDONNELL, JR., individually, as Trustee under the Will of James F. McDonnell and as Executor of the Estate of Anna M. McDonnell, and CHARLES E. MCDONNELL, as Executor of the Estate of Anna M. McDonnell,
Plaintiff-Appellants,

against

THE NEW YORK STOCK EXCHANGE by ROBERT W. HAACK, THE NEW YORK STOCK EXCHANGE, INC., THE AMERICAN STOCK EXCHANGE by H. VERNON LEE, JR., Secretary, and MCDONNELL & CO., INC.,
Defendants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

JOINT APPENDIX (Vol. A-6)

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MARGARET MARY MC DONNELL MURPHY, et al.

vs. 71 Civ 461
71 Civ 1940

MC DONNELL & CO., INC., et al.

May 14, 1975
10:00 a.m.

Trial resumed.

- - -

(In open court; jury present)

P A U L M C D O N A L D resumed.

CROSS-EXAMINATION

BY MR. BEEBE:

Q Mr. McDonald, yesterday you testified about some events that occurred late in 1968 when you were invited to look at the company, McDonnell & Company, and asked whether you could arrange or yourself contribute funds to its capital.

What was the form in which you were asked to make that investment?

A It would have been in the form of a subordinated loan.

Q And did you examine the subordinated loan instrument that you were being asked to enter into?

A Yes, sir.

Q What conclusion did you reach?

A I concluded that it was not a relationship which I would enter.

Q And what was your reason for that?

A The subordinated loan agreement, in my judgment, surrenders substantially all rights of the lender to his money and subordinates it to a very high degree of risk.

I think that my comment at the time was that I might just as well walk over to the window and drop the money out.

Q Did you look at the financial and operating condition of McDonnell & Company at that time as well?

A Up to a point, yes, sir.

Q Had you observed at that point in the fourth quarter of 1968, that the business of the company, brokerage activity had slowed down?

A I did not at that time observe that fact. I saw it later in retrospect.

Q Sir, if I might remind you from your deposition, page 13, your answer was to the question:

"Q Can you tell me what information you received that led you to the conclusion it was not an opportunity which you felt where you should invest your money? "

You said:

"A They also gave me a financial statement which indicated that the brokerage activity of the business had slowed down in the fourth quarter of 1968 and, of course, this was expanded levels of expense."

Does that refresh your recollection that you were?

A Yes, they did give me such a statement. They couldn't have given me such a statement for the fourth quarter before the end of the fourth quarter.

Q So the statement they gave you during the fourth quarter indicated that business had already slowed down somewhat in the brokerage area?

A Well, I always have difficulty pinpointing the time six years ago when I learned a fact.

Q In the course of making your decision not to make the investment at that time, were you told that they were having problems with the requirements of the New York Stock Exchange?

A I was told that they were having capital problems. Now, again, whether I learned that it was a 325 problem then or whether I learned it later is very difficult for me to identify.

Q If I remind you the next page of your deposition which you gave in this case on October 9, 1973, almost a year and a half ago, your recollection might have been a little better. The answer to the question of whether you were informed prior to April of 1969 that they were in violation, your answer was:

"They told me they were having problems with the requirements of the stock exchange. Exactly which problems they depicted and whether or not they indicated that they were in violation I can't be certain. I feel very strongly they did not tell me they were in fact in violation of any requirements of the New York Stock Exchange, or plainly I wouldn't have even considered the investment.".

A I don't see that that conflicts with what I just said.

Q My question is, sir, why would you not have even considered the investment if they were in violation or if they told you they were in violation?

A Well, it would be a very poor judgmer .

MR. BROOKS: It's a hypothetical question since that state of facts, according to the witness' testimony, was never presented to him.

MR. BEEBE: I believe the evidence indicates the state of facts did exist.

MR. BROOKS: Not to the knowledge of the witness.

THE COURT: I'm not so sure this is relevant to our inquiry.

You are then going to draw some parallel to somebody else where the facts may be different? You are getting an opinion from this man as a potential investor. How does that bear on any other potential investor or actual investor?

MR. BEEBE: For instance, your Honor, if the jury finds that the --

THE COURT: Let's not get into alternatives of that kind. Do you claim they can draw a conclusion from what this man might or might not have done in '68 as to what someone else in the McDonnell family might or might not have done in '69?

MR. BEEBE: This is 1969, the end of '68.

THE COURT: He is talking about '68, the fall of '68.

I am going to sustain the objection.

MR. BROOKS: It's important to note Mr. McDonald was investing other people's money, not his own.

THE COURT: I don't think the opinion of this gentleman is relevant or probative.

BY MR. BEEBE:

Q Were you informed at that time of the status of the books and records of McDonnell & Company for the year 1968?

A By "at that time" you mean the last quarter of 1968?

Q At the time you were making your decision, which I understand was the last quarter of 1968 up to February of 1969?

MR. BROOKS: Oh, your Honor, that testimony has never been given by the witness, up to February, 1969.

MR. BEEBE: It was made in his deposition.

THE COURT: Let's lay a foundation, then, for this.

Q How long did you consider or review the questions before you made your final decision not to go ahead with some investment?

A It was in February of 1969 that I came up from Florida and told them that I was not going to make the investment.

Q Now, having laid that foundation, were you informed prior to that time as to the status of the books and records of McDonnell & Company for the year 1968?

A Well, I don't mean to be evasive. Certainly I

was told how the business was going. I saw financial statements as recent as they had at that time, and I saw a rather detailed cash flow projection for the future of the business.

Now, I certainly didn't go into books and records, which I think is your term, myself fully in an accounting sense.

Q I didn't mean it in an accounting sense; I meant it as of the status of the records of the company, its own record keeping, if it had any record keeping problems at that point.

A Oh, record keeping problems? Yes, I was definitely told that there were record keeping problems.

Q And were you told that those record keeping problems came from the attempts to automate, put the company's records on a computer?

A That was the primary cause that was blamed, yes.

Q Were the record keeping problems and the capital problems given to you as some of the reasons for requesting you to arrange or help to raise some capital?

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A Not really. The primary reason given to me was growth and expansion.

MR. BROOKS: Your Honor, I am going to object for the same reason we did before, that I don't think it

appropriate to try to draw a parallel of Mr. McDonald's experience as investment adviser and decisions about whether or not to put his client's money into this firm.

MR. BEEBE: That is not the sole purpose of bringing up his testimony, your Honor. The purpose is to bring out what was known to the company at the time and what the company informed the man who asked the right questions. These were the facts that the company had in its possession, and there could be, then, no question if we can show it --

THE COURT: Objection sustained.

Q Did there come a time when Margaret Murray Muphy came to your office with her husband and discussed with you her subordinated position at the company? I can pinpoint that, I believe, in September, 1969.

MR. BROOKS: I rose to object that it was not within the scope of the direct, but I am not sure about that now, so I will sit down.

A They could have, counsel. There were many visits by many people, and I am having difficulty recalling that specific visit with those people, but they certainly could have.

Q Well, Mrs. Murphy, do you recall her requesting quite vigorously the right to withdraw from the company, withdraw her subordinated account?

A I don't recall that, but that doesn't mean it didn't happen.

Q Do you recall the telephone conversation with her which one might characterize as extremely vigorous on her behalf making this request?

A I recall one or two telephone conversations with her in which she expressed some discontent with the state of affairs. Whether she specifically on some particular telephone call demanded anything in particular, I honestly don't recall.

Q Did you at the meeting at the Carlton House offer Mrs. Anna McDonnell the opportunity to withdraw her subordinated account?

A Oh, I would not think so, counsel. I don't believe we offered anybody any out at any time.

Q That would include Mrs. Murphy?

A I think that is correct.

Q Mrs. Murphy was at the Carlton House meeting, was she?

A I don't know. I was more or less asked that yesterday, and I went into that meeting without, I think, being introduced to the individuals. So they could have been there.

Q Would you know of any reason why she had not

been invited?

A No.

Q You mentioned a black Friday plan yesterday. Will you describe for the jury what black Friday plan is?

A Well, in many companies, at least in my company, that is just a handle that we use to describe a down side contingency plan.

Q If everything goes wrong --

A - here is what we could do to liquidate the business.

Q You mention that the staff had prepared that. Was that plan in existence in writing somewhere?

A Pieces of it were in writing.

Q Was it in existence before you arrived on the scene?

A Pieces of it were.

May I answer that a little more fully to clarify it?

Q Please do.

A I really don't think that the plan was developed before I got there, because there wasn't any contemplation given to liquidating the company. There were two or three very vigorous schools of thought in the company as to which direction it should go, so they had put together alternative plans for closing down this part which we don't like, closing

down that part which you don't like.

Q Did they receive any direction from the New York Stock Exchange?

MR. BROOKS: If he is asking the witness what direction they received, and the witness was not on the scene, I will object.

THE COURT: Yes, sustained. Absence of foundation.

BY MR. BEEBE:

Q Do you know from what you learned after you came on the scene whether before that time McDonnell & Company had received any specific direction from the New York Stock Exchange?

A I really can't testify as to what was -- what transpired before I got there, no.

Q You testified yesterday -- moving now to a period in 1970 -- that the SEC moved to impose sanctions on the firm or individuals in the firm for prior practices.

Were you one of those individuals?

A Oh, no.

Q Was this before your tenure?

A Certainly.

Q What were the prior practices?

A Well, by and large they were brokerage practices performed by individuals in various branch offices years

before even --

Q Apart from the brokerage practices, what were they?

A Then there were some management problems particularly regarding the chief executive of McDonnell & Company.

Q Anything you can recall? Were there capital problems?

A Oh, well, this is within the compass of the management problems, to my recollection.

Q Record keeping problems?

A Yes.

Q How far back did they go?

A How far back did the problems go or the charges?

Q The charges.

A I don't know.

Q The problems.

A I would say it was years rather than weeks.

Q You mentioned a press release in August, 1968. Did the company ever issue a later press release or any other public announcement changing or retracting what had gone out in the first press release?

A No, I don't recall that they ever did. It was considered, but there never was a moment during the ensuing

months when we didn't think that we might have more or less that same $3,000,000 from some other source.

Q But it never came in?

A It never came in.

MR. BEEBE: No further cross.

MR. BROOKS: I have one or two questions on redirect.

REDIRECT EXAMINATION

BY MR. BROOKS:

Q Mr. McDonald, you said that when you analyzed the subordination agreement which was proposed that your clients might put some money into McDonnell in the late 1968 period, you determined from reading that agreement that was not the position that you would advise an investor to take, sir.

Now I show you Plaintiffs' Exhibit 3, which is Mrs. Murphy's subordination agreement, and ask you if that was the kind of agreement that was presented to you at the time in late 1968?

A This is a rather lengthy document.

Q I realize it is somewhat unfair to ask you to make an analysis of it while you are sitting here, but perhaps without doing that you can get at it another way.

Can you tell me what particular features in the subordination agreement that was presented to you you

found objectionable and why?

A Well, I think if I had time I would be able to identify language in here -- maybe this is it here in the subordination, section 2, which makes very clear that the investor in the event of any kind of trouble is absolutely the last person to get any money out of the firm, and I would think that normally a creditor position would be better than that.

Q In other words, a bank making a loan to a brokerage firm would stand ahead as a matter of priority to a subordinated lender?

A So I understand.

Q Would a subordinated lender, as you understood it, be in a worse position than a stockholder holding equity stock?

A Well now, just right now without analyzing this I couldn't answer that question, but certainly this agreement, as I recall reading it six or seven years ago, surrenders substantially all rights, and there are places you can put your money where you don't have to do that.

Q Can you tell me from the review that you have made of Exhibit 3 whether it was in general the same kind of subordination agreement that you considered in late 1968?

A I clearly remember some of this language, counsel.

(Pause)

A (Continuing) If this is different om the subordination agreement which I viewed at the time, I cannot presently identify the difference.

The substance of what I see here is the sort of thing that frightened me away, and I would read one sentence as an example if you would want me to.

Q Please do.

A "With respect to each account the owner hereby agrees to subordinate and hereby irrevocably does subordinate any and all claims which he has as an owner, creditor, or otherwise may now or at any time hereafter have against the corporation to the claims of all other present and future creditors of the corporation arising out of any manner occurring."

It seems to me that investing your money subject to claims of unknown future creditors and events that will happen down the road is not a risk that a professional investor would take.

Q Youdiscussed with Mr. Beebe this morning whether it had been explained to you in Februray of 1969 whether, I guess it was the back office or books and records problem, I'm not sure which phrase he used, had been caused by the computer conversion.

A Right.

Q Did you learn when you came upon the scene in the summer either through the records of the firm that you might have examined or through personnel with whom you spoke who were present at the time, that while the conversion was being attempted the firm had run a parallel system of record keeping on its already established NCR system?

A Yes. There were two systems in operation. The old manual system, which I understood was deficient, and the new computerized system which was very expensive and I understood deficient.

The analogy given to me was they had the front end of a Rolls Royce and the back end of a Model T.

Q Was the front end, the Rolls Royce, in the testing stage in late '68 and early '69, if you know from your examination of the records or from conversations?

A I would say it was in the testing stage and more. They were testing it and they kept trying to convert certain parts of the work load to it.

Q Do you know what schedule they were on when they converted what part?

MR. BEEBE: I object to extensive testimony

before the gentleman was there. I was blocked in that line of inquiry in my examination.

THE COURT: Is that a basis for competent knowledge of this witness, Mr. Brooks?

MR. BROOKS: Well, the witness hastestified thatwhen he arrived in June or July he did have discussions with employees that had been there in the past and had reviewed some of the records. If he didn't learn this knowledge, he can't answer me. If he did perhaps he can.

MR. BEEBE: I suppose it's also hearsay.

THE COURT: I sustain the objection.

Q Mr. McDonald, you testified that you had received a telephone conversation or you had a telephone conversation, perhaps a meeting with Mrs. Murphy and that she was dissatisfied with the state of affairs at McDonnell & Company, but you weren't sure whether she asked to withdraw her account or not?

MR. BEEBE: I object to the characterization. I don't think that's what he testified to.

MR. BROOKS: I'm just trying to focus the witness. I'll withdraw the characterization.

Q I want to direct you to whatever conversations you had with Mrs. Murphy either on the telephone or in

writing after the time you came to McDonnell & Company. I want to ask you if she ever told you she had been asked to make her subordination in February of 1969?

A My word, I mean words were used. Whether those were among them I can't recall.

Q Can you tell me what she said?

A Can I tell you what she said?

Q In that vein.

A She certainly expressed some doubts, at least, as to whether she had been fully and accurately informed.

Q And what did you say to her?

A Oh, I don't know that there was much I could say to her as to communications given to her before I was on the scene, in some cases by family members. What do you say?

Q How about Mrs. Anna McDonnell, did she ever tell you that she believed she had been defrauded?

A No, sir.

MR. BROOKS: No further questions.

RECROSS EXAMINATION

BY MR. BEEBE:

Q Just one or two questions on this Exhibit 3, Mrs. Murphy's subordination agreement.

Sir, this has a hundred-day withdrawal provision in there of some sort. Do you know if at that time the people who had this kind of agreement could withdraw on a hundred days notice, and by that time I mean August, September 1969? There is also a provision in there about permitting the withdrawal unless the withdrawal will put the company over certain monetary limits.

MR. BROOKS: I think it calls for a conclusion of law by the witness.

MR. BEEBE: He was experienced in that area.

THE COURT: I had thought it called for a statement of whether anybody made an effort to avail themselves of any clauses.

MR. BROOKS: It wasn't that narrow, your Honor. It was more in terms of whether there was such a prohibition against availing oneself of that clause.

THE COURT: Do you want to direct his attention to the clause and ask him what he knows about it?

Q Sir, you were well acquainted with the capital situation of McDonnell & Company in the summer

and fall of 1969, were you not?

A Yes.

MR. BROOKS: Your Honor, I am going to add an objection. I think before we go along this line we first should establish whether any such demand was made. Because if it were not made then I think these questions are irrelevant.

MR. BEEBE: I disagree completely. If there was no purpose in making it, if it would be an empty act. That's the question.

THE COURT: You have to go more than that. You have to prove people knew it would be an empty act.

MR. BEEBE: That's what I am asking this itness.

THE COURT: Let's get down to that.

Q Mr. McDonald, I am trying to find the particular clause. I direct your attention to page 10.

A That's where I am.

Q You are already there.

A I'm glad you found it.

Q I'm glad you found it. And I'll read here:

"Prior to the occurrence of an event of subordination the owner shall have the right at any time,

and from time to time in each instance on at least 30 days prior written notice delivered to the corporation, to withdraw securities from an account if after such withdrawal the aggregate indebtedness of the corporation would not exceed 1500 per cent of its net capital determined in accordance with the capital requirements and regulations of the exchange applicable to the corporation as promulgated by the exchange and in effect at the time of the withdrawal."

We are in the summer of 1969. Could Mrs. Murphy have withdrawn her funds --

MR. BROOKS: I object to the question because that passage Mr. Beebe read is prefaced by the condition prior to the occurrence of the event of subordination. I think we can't answer this in the abstract unless we know there was such an event of subordination.

MR. BEEBE: I'm getting at the 1500 per cent and then we will talk about construction of the instrument in terms of how it functions.

I believe an event of subordination is defined on page 3, your Honor, top of page 3, little "g", to the effect that the company goes bust.

MR. BROOKS: I object to the characterization.

I also object to the distinction that counsel

is apparently flying over between withdrawl of securities under an existing subordination agreement, which is the paragraph 7 he is reading, and expiration of the existing subordination agreement, which is where he started, paragraph 1a. I think they are not at all related.

THE COURT: At this point I will overrule the objection.

Are you able to answer that question?

THE WITNESS: Could somebody tell me which question now.

THE COURT: Whether in August of 1969 Mrs. Murphy could have taken her money or securities out under this agreement?

That, I suppose, gets you down to the question of what the capital ratio was.

THE WITNESS: Exactly. All right, I understand.

My answer has to be I do not know. I think that I have said before that we were into some very serious definitional problems since this was an early case in the distress of the Wall Street houses, and we really did not know in some cases what items could be considered capital for 325 purposes and what could not.

We had to presume the most conservative stance. I'm sure that if Mrs. Murphy asked for the return of her investment and it would be very difficult to interpret her attitude as anything else, we had to decline because we weren't sure whether that single act might put us over the 325 line.

Q In any event, you did decline? The company did decline?

MR. BROOKS: I object.

THE COURT: Has there been any showing of a demand?

MR. BEEBE: His last words were that it was hard to interpret her attitude as anything else.

MR. BROOKS: Mrs. Murphy testified she never made a demand.

THE COURT: I seem to recall some proof that could be so construed. In any event, the record speaks for itself and the jury will have to makea determination based on the evidence before it.

Go ahead. Next question.

Q You mentioned after examining the subordination that was tendered to you in 1968 or early 1969 you made the determination that that was a risk that no professional investor would take. You just testified to thaton

Mr. Brooks' redirect examination.

A That was my conclusion.

Q Was it a risk that a non-professional investor should take?

MR. BROOKS: I object.

THE COURT: Sustained.

MR. BEEBE: No further recross.

MR. BROOKS: One question, your Honor, just in this area.

REDIRECT EXAMINATION

BY MR. BROOKS:

Q Look at page 1a of the subordination agreement, where it says:

"The agrement shall expire the hundredth day following the day on which the owner delivers written notice to the corporation demanding termination of this agreement."

A I don't see any 1a, counsel.

MR. BEEBE: He means paragraph 1a, I believe, on page 1.

Q The first page, right about in here (indicating)

Let me read that so we all have it before us.

"Expiration date shall mean the hundredth day following the date on which the owner delivers written notice to the corporation demanding termination of this agreement."

While you were functioning as an officer or consultant to McDonnell & Company, Mr. McDonald, did you ever get such a written notice from Mrs. Murphy?

A No, I don't believe I did.

Q Did you ever get it from Anna McDonnell?

A From Anna McDonnell --

Q In respect to Anna McDonnell's subordination agreement which we come to know has been dated --

A Her own personal investment?

Q Mrs. Anna McDonnell's subordination agreement which is a form almost identical to this and it's in evidence.

A You are speaking of her as an individual and not as trustee of the estate?

Q Yes.

A No, I don't believe we ever did.

Q Did you ever see or hear of such a document being in the records of McDonnell & Company, which document might have arrived prior to your arrival in late June and July?

A No, I don't believe I did.

MR. BROOKS: No further questions.

THE COURT: All right, Mr. McDonald, you are excused.

(Witness excused)

MR. BROOKS: Your Honor, we have now a brief reading from the deposition of Fred J. Stock, who is a deceased officer of the exchange whom we heard about in the testimony. Again Mrs. Solomon and Mrs. Lichstein will do the reading. The deposition was taken by Mr. Dubin a few years ago.

MRS. LICHSTEIN: We are going to start on page 3.

"Q Mr. Stock, will you tell me something about your educational background, starting with approximately graduation from high school.

"A I graduated from Archbishop Stepinac High School, White Plains, New York, and from the Hackley School, Tarrytown, New York. I then graduated from Purdue University in 1960.

"Q What degrees did you take at Purdue?

"A Bachelor of Science and Industrial Economics.

"Q Did you have any further education or

training?

"A I've taken certain other special courses, but none leading to a degree.

"Q What other special courses did you take?

"A Courses in data processing, brokerage accounting, brokerage procedures, that type of course.

"Q Where did you take those courses?

"A Various places. The IBM schools, Pace College, New York Institute of Finance and New York University.

"Q How old are you, Mr. Stock?

"A 35.

"Q When did you first become employed on a full-time basis?

"A July of 1960.

"Q Would you relate to me in a chronological order your vocational background?

"A In July of 1960, I joined the brokerage firm of Dominick & Dominick, in the operations area. I worked through several departments there. And I believe it was January of '65, I went with the Midwest Stock Exchange Service Corporation as a systems representative.

"Q What is a systems representative?

"A A systems representative is responsible for converting broker-dealers to the computerized bookkeeping system offered by the Midwest Stock Exchange Service Corporation.

"Subsequent positions with the Midwest were that of systems manager, and then a vice president.

"Q Is this still out in the Midwest Stock Exchange?

"A Yes, it is. In December of '68 I left the Midwest to join the New York Stock Exchange staff.

"Q In what capacity did you join the New York Stock Exchange in December of 1968?

"A As Assistant Vice President and an Associate Director of the Department of Member Firms.

"Q You said Assistant Vice President and Associate Director of the Department of Member Firms?

"A Yes.

"Q Have you retained those titles to the present, or have you --

"A No, I'm now a Vice President of the Exchange.

"Q When did you become the Vice President of the New York Stock Exchange?

"A About two and a half months ago.

"Q Prior to being made the Vice President of the New York Stock Exchange, you held the titles of Assistant Vice President and Associate Director?

"A That is correct.

"Q What were your duties as Assistant Vice President in the year 1968 and 1969?

"A My primary duties were with respect to the operational and capital surveillance of member organizations.

"Q By capital surveillance, do you mean checking the Rule 325 computations submitted by member firms?

"A Yes.

"Q What were your primary duties as Associate Director of theDepartment of Member Firms during these same two years, 1963 and 1969?

"A The same.

"Q Capital surveillance?

"A Yes."

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"Q Would you tell me who your direct superior was, the gentleman you reported to?

"A Mr. Robert M. Bishop.

"Q Mr. Bishop was Vice President and head of the Department of Member Firms?

"A Yes."

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"Q Is there a procedure now in existence at the New York Stock Exchange, requiring the providing of financial data of a member firm to a subordinated lender, prior to the subordinated lender making the loan?

"A There is not a procedure of the Exchange per se for it to provide data to the subordinated lender.

"Q By procedure, you also include that there is no rule in existence?

"A That's correct. The exchange does not provide any information to them.

"Q I'm sorry, I'm losing you now.

"A I say, the exchange does not provide any information to the potential subordinated lender.

"Q Were you aware in 1969 of the existence of a letter which has been termed a 'knowledgeability letter'?

"A Yes.

"Q Can you tell me the genesis of this type of letter?

"A That letter was required by the exchange

in certain instances to dispel the potential lender from any possible belief that he has a form of protection from the exchange in conjunction with his capital contribution.

"Q Do you recall when the use of knowledgeability letters first came into existence?

"A I would think the first ones were required some time in '68 or 1969, on a selective basis. In 1970, such language became incorporated in our standard agreements.

"Q In the standard subordination agreements; is that correct?

"A Yes.

"Q Did the New York Stock Exchange draft suggested forms as to the subordinated loan agreement?

"A In what period of time?

"Q 1968, 1969.

"A There was a general form that was used by the majority of member organizations. However, they did not have to specifically use that form.

"Q Could the member firm use its own form and seek approval ofthe New York Stock Exchange as to the type of subordination agreement being used?

"A Yes.

"Q And that was followed in many instances, I take it?

"A In some instances, yes.

"Q You mentioned a few moments ago that the use of knowledgeability letters was required on a selective basis. Can you tell me who made the decision as to what member firms having subordinated lenders would have knowledgeability letters issued?

"A That decision generally would come from one of three sources: Mr. Bishop, myself, or the coordinator for the member organization."

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"Q Do you know who the coordinator was for the firm of McDonnell & Company during the year 1969?

"A I believe during the year of 1969, there was more than one coordinator for the firm.

"Q I believe one of them was Mr. George Newman. Would that be correct?

"A I believe Mr. Newman became the coordinator some time during 1969.

"Q Do you know who was his predecessor?

"A I believe it was Mr. Schuette.

"Q Mr. Herbert Schuette?

"A Yes.

"Q You mentioned that in addition to the coordinator, it was Mr. Bishop or yourself who chose what firm should issue a knowledgeability letter; is that correct?

"A Yes.

"Q Do you recall, as it relates to McDonnell & Company, informing McDonnell & Company that they were required to issue knowledgeability letters?

"A I don't specifically recall.

"Q Can you tell me what criteria you used in determining what member firm should issue a knowledgeability letter to its subordinated lender?

"A There were not specific criteria. It was a

matter of judgment.

"Q And in this judgment, you would take in all the aspects as to the financial and operating conditions existing in the member firm?

"A Among other things, yes.

"Q What would be the other things you would consider?

"A I think another consideration would be who was the party contributing capital.

"Q By that you mean the degree of sophistication of the party?

"A The degree of sophistication, the degree of closeness to the member organization.

"Q Do you recall approving a subordinated loan for the firm of McDonnell & Company during any part of the year 1969?

"A I recall that there were capital infusions approved by the Board of Governors during 1969.

"Q That's the Board of Governors. Do you recall yourself having seen applications for subordinated loans to McDonnell & Company, in your capacity as Associate Director and Assistant Vice President?

"A I don't recall having seen specific applications or subordination agreements in that period myself.

"Q I believe you said something to the effect of

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depending on who the person is, as to the subordinated loan, and I believe I mentioned to you the degree of sophistication. Is there any other aspect that you can tell me about as to when you would choose to have a knowledgeability letter issued?

"Mr. Brooks: Mr. Stock has told you of some other factors, Mr. Dubin. You mean other than those other factors?

"Q You said degree of sophistication was one aspect. Could you tell me other ones?

"Mr. Brooks: He already has told you other ones.

"Q Would you be kind enough to tell me again?

"Mr. Brooks: No, he won't tell you again. We only answer the same question once."

Then there was an objection, and then follows this question:

"Q Would you define what you mean by 'degree of closeness'?

"A By 'degree of closeness,' I would mean primarily is the capital contributor himself a member or allied member of the organization, or a member of his immediate family.

"Q What difference would that make to you in your determination?

"A Well, the members and allied members, particularly

those who are principal executives of the organization, as well as their immediate family, we felt were more likely to know all of the material facts about the condition of the organization than, say, some customer who has an account there, and who has been asked to subordinate his account, and has absolutely no other relationship with the firm.

"Q Did you make an investigation to determine for yourself whether the proposed subordinated lender had indeed been informed of the financial and/or operating conditions existing at the member firm where the proposed subordinated loan was to take place?

"A No, we did not.

"Q But you did make a differentiation in your mind as to the type of person making the subordinated loan?"

There was a discussion and then another question was asked:

"Q You did make the differentiation in your mind? You said degree of closeness—

"A This was one of the factors that was included in our judgment as to whether or not we should request a letter.

"Q The letter we are talking about, the knowledgeability letter, can you define exactly what, in substance, that letter stated?

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"A In substance, it stated that they have made whatever review of the financial and operational condition of the member firm they deem is appropriate; the fact that they are not looking to the Exchange, its officers, governors, special trust fund, for any information with respect to the firm, or any protection for their investment.

"Q You have now named two criteria, that being the degree of sophistication and the degree of closeness, and you defined what you mean by degree of closeness. Were there any other criteria that you had in mind?

"A I believe I also stated it was the financial and operational condition of the member organization.

"Q And you had determined the financial and operating condition of the member firm how?

"A Based upon the information which the Exchange had on the firm.

"Q Would you look to the last financial analysis of the member firm's capital ratio, or did you look to the past record for the member firm for the past year, or what analysis did you make as to the financial and operating condition?

"A We probably looked at the most recent data we have."

MRS. LICHSTEIN: Page 79:

"Q Have you had, during the year 1969, conversations

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or correspondence or meetings with any member of the Securities & Exchange Commission in relation to the firm of McDonnell & Company?

"A Yes.

"Q Would you tell me whether it was a correspondence?

"A I don't believe I had any correspondence with the SEC staff.

"Q Did you become aware of correspondence to the SEC staff?

"A During 1969?

"Q That's correct.

"A I believe there was correspondence between the Exchange and the SEC.

"Q Do you know who at the Exchange initiated or was the recipient of these correspondence?

"A Not specifically.

"Q Did you have conferences with members of the SEC staff as it relates to McDonnell & Company?

"A At the moment I don't recall any specific conferences as it relates to McDonnell & Company.

"Q Did you have conversations, phone conversations, with members of the SEC staff as it relates to McDonnell & Company?

"A Yes.

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"Q Who did you have these conversations with?

"A I've had conversations with Mr. Barton.

"Q Joseph Barton?

"A Yes.

"Q Of the New York Regional Office of the Securities and Exchange Commission?

"A Yes.

"Q Who else?

"A I may have had conversations during that period with Messrs. Duffy, Sporkin & Pollack.

"Q Those would be members of the SEC staff in Washington?

"A Mr. Duffy was in New York.

"Q Mr. Sporkin and Mr. Pollack are Washington SEC staff members?

"A Yes.

"Q Do you recall the substance of your conversations as to McDonnell & Company with these gentlemen you just mentioned?

"A It would be a general discussion of the condition in the firm, as we knew it to exist at that particular moment in time.

"Q Were you aware, during the year 1969, of an investigation of the firm of McDonnell & Company by the

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Securities & Exchange Commission? Were you made aware of such an investigation?

"A I am aware that there was such an investigation. I'm not sure if I was made aware of it during 1969 or 1970.

"Q Do you recall what the substance of this investigation as to McDonnell & Company consisted of?

"A As I recall, its initial focus was on compliance with Regulation T.

"Q Do you recall whether the investigation included anything besides the investigation of Regulation T?

"A I believe that ultimately it included books and records and capital, as well as Regulation T.

"Q Did you, during the year 1969, ever ask anyone at the Securities & Exchange Commission to defer their investigation of McDonnell & Company for any reason whatsoever?

"A I would say no.

"Q Are you aware of any other person at the New York Stock Exchange who asked the Securities & Exchange Commission to defer their investigation of the firm of McDonnell & Company during the year 1969?

"A I don't recall anyone so requesting.

"Q Was it a policy of the New York Stock Exchange to ask the Securities & Exchange Commission to defer an

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investigation of a member firm while the New York Stock Exchange had its own investigation of a member firm presently in existence?

"A I don't think there was a policy to make such a request per se.

"Q Do you know of any instance where the New York Stock Exchange asked the Securities & Exchange Commission to defer the Securities & Exchange Commission investigation in light of the fact that the New York Stock Exchange was investigating one of its own members?

"A During 1969, there were certain cases dealing with the books and records rules of the Exchange and of the Commission, where the Exchange had discussions with the SEC staff to the effect that the Exchange was planning to bring disciplinary action, and that there may not be a need for the Commission staff to commence an action.

"Q Do you recall that in relation to the firm of McDonnell & Company?

"A Not specifically. It's possible that there were such discussions."

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The testimony that we are going to now read refers to an exhibit already in evidence as Exchange Exhibit GG.

"Q Please look at Plaintiffs' Exhibit 66 and tell me whether you have ever seen this document before.

I also direct your attention to the bottom handwritten notation.

"A I have seen this memorandum before.

"Q The memorandum is dated April 7, 1969. The handwritten notation is dated April 17, 1968, with the statement, 'Meeting of R.M.B.,' which is Mr. Bishop, 'F.S.,' which is you, Mr. Stock, 'and T. Murray McDonnell. No restriction imposed.' The signature below that is that of Mr. Schuette.

Can you tell me the substance of the conversation between Mr. Bishop and Mr. T. Murray McDonnell and yourself regarding the imposition of restrictions?

"A The basic substance was what steps the firm was taking to correct their problems, as well as the self-imposed restrictions that they have put on their business.

"Q I believe your testimony concerning Plaintiffs' Exhibit 64 was that you had recommended imposition of restrictions at that meeting. That document speaks of April 2, 1969.

Can you tell whether you, first of all, agreed with not imposing restrictions as of April 17, 1969?

"A I did.

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"Q Can you tell me what changed your mind, within the 15 days, as to why restrictions should not be imposed?

"A The steps outlined by the management of McDonnell & Company.

"Q Did you incorporate McDonnell & Company's voluntary restrictions as the New York Stock Exchange restrictions?

"Mr. Brooks: I don't understand the question.

"Q Do you, Mr. Stock?

"A I'm not sure that I understand it.

"Q Is there a procedure whereby the New York Stock Exchange can treat a voluntary restriction as its own restriction?

"A Yes.

"Q Did you treat the voluntary restrictions of McDonnell & Company as if they were imposed by the New York Stock Exchange?

"A No.

"Q Do you recall what restrictions Mr. McDonnell imposed upon himself that changed your mind within the 15 day period?

"A I did not state that iw as solely the restrictions which he imposed which made me change my mind.

"Q Would you tell me what other criteria changed

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yourmind within the 15 day period?

"A The other various steps that were taken in addition to the self-imposed restrictions.

"Q What are --

"A Were a contributing factor.

"Q What are the other steps taken?

"A As I recall, they had retained consultants and research people to help resolve their problems. I believe they had their auditors working on the situation with them. One of the things that was presented was the introduction of Mr. O'Brien as the president of the firm, to better manage the affairs of the company.

"Q Do you recall whether Mr. O'Brien, in your opinion, was qualified to be president of a member firm of the New York Stock?

"The Witness: Do I get sued for libel if I answer?

"Mr. Dubin: No.

"Mr. Brooks: Not by Mr. Dubin.

"Mr. Dubin: Not by me, and also it is privileged information in a lawsuit.

"A I really had no basis on which to determine whether or not Mr. O'Brien was qualified to manage a-- be president of a member organization.

"Q Do you know whether Mr. O'Brien had any experience

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whatsoever in the securities business?

"A I don't believe Mr. O'Brien had experience in the securities business. However, he had had considerable managerial experience.

"Q You had mentioned as one of the criteria that changed your mind within this 15 day period, the aspect of McDonnell imposing self-restrictions. Do you recall what self-restrictions were imposed by McDonnell?

"A Among the self-imposed restrictions that I recall were they had discontinued advertising and other promotional activities. They were not opening any new offices. But certain limits on the types of securities that they would let their customers trade in. Put certain restrictions in on minimum margin required for new accounts. Items like that."

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"Q Do you recall informing the Securities & Exchange Commission of a violation of Rule 325 by McDonnell & Company during any time of the year 1969?

"A Informing them?

"Q Yes, sir.

"A Or violation during the year?

"Q Informing them of a violation. You have learned, as your testimony has revealed, that you were aware of the

October 31, 1968 violation, the January 30, 1969 violation.

"A Is your question, though, did we inform them in 1969?

"Q That's correct.

"A I would say we discussed the fact that there had been a violation or violations, during 1969, with the SEC.

"Q Do you recall who you discussed this violation with, or violations?

"A I would say Mr. Barton, Mr. Duffy, Pollack and Sporkin.

"Q Do you recall any one of these gentlemen in particular, or it could have been any one of them?

"A Those are the gentlemen with whom I frequently had discussions on similar situations."

MRS. LICHSTEIN: We are finished, your Honor.

MR. BROOKS: I would call as the next witness Robert M. Bishop.

R O B E R T M. B I S H O P, called as a witness, having baen duly sworn, testified asfollows:

DIRECT EXAMINATION

BY MR. BROOKS:

Q I will ask you for the record, Mr. Bishop, by

whom are you employed?

A The New York Stock Exchange for 20 years.

Q In what capacity are you presently employed?

A Senior vice president.

Q What are your duties in the office which you now hold?

A I supervise all regulation by the Exchange of its member firms and the floor of the Exchange.

Q Is that where the actual trading goes on of securities?

A Yes.

Q Can you tell me what your educational background has been?

A I am a graduate of Union College in Schenectady with a Bachelor of Arts degree in American civilization; I have a Master's degree from Trinity College in Hartford in public service; and I was an Air Force pilot and went through their educational program; and then I have had education in securities at the Exchange.

Q Did the Master's course which you took require a thesis?

A Yes.

Q Did you write one?

A Yes.

Q What was the thesis?

A The public service function of the New York Stock Exchange.

Q Did you have employment other than the service before your Air Force days?

A Yes.

Q What was that?

A I was assistant director of public relations at Union College for two years. Then I was director of public relations at Trinity College for eight.

Q And then came the service?

A No, the service came in between my graduating and my working for Union.

Q Was that World War II, sir?

A Yes.

Q Where did you seek employment when you finally left the campus?

A The New York Stock Exchange.

Q And in what capacity?

A In 1955 I became assistant to the president.

Q Would you trace your career briefly between 1965 and 1969, just tell us the offices you held and generally what that meant and what you did in these offices?

A In 1960 I went into regulatory work as associate

director of what was called the Department of Member Firms liaison. I really went in order to build a new examination system for registered representatives, the people who sell securities. The exchange conduct examinations when people become registered representatives in order to make sure that they arewell qualified.

That also had member firm relations activities, and I was engaged in those activities for about two years.

Then I went pretty much full time into regulation as associate director of the Department of Member Firms, of which the member firms liaison department had been a section.

And in 1963 I became a vice president as well as associate director of the Department of Member Firms, and also immediately I started directing the department since the director had a heart attack, but he didn't retire until 1965 when I firmly became director of the Department of Member Firms and continued being that until I think about a year and a half or two years when I became a senior vice president, and then took on the additional duties of regulating the floor of the exchange. Previously I had just been regulating the member firms.

Q Do you still regulate member firms?

A The staff under me does, yes.

Q I take it in 1968 and 1969 you were the head of the Department of Member Firms, and that department had regulatory jurisdiction over McDonnell, is that true?

A That's true.

Q What kind of legal entity is the stock exchange, sir?

MR. BEEBE: Objection. I think we should go back to the time period involved.

MR. BROOKS: We do plan to take that trip, your Honor, but we thought we would start here.

MR. BEEBE: The present structure of the exchange is irrelevant. What they were at the time is, of course, what matters.

THE COURT: If it's only a matter of relevance, let's get a little background.

Overruled.

BY MR. BROOKS:

Q What kind of legal entity is the exchange?

A I think what is called a nonprofit corporation under New York State law.

Q Let's take Mr. Beebe's question, sir. Where did it all start? Give us just a brief sketch of the history of the New York Stock exchange from where it started to where it got to be a nonprofit corporation.

A Okay.

The stock exchange started sort of informally in 1792 when there weren't many securities in the United States; they were mostly government securities, and some people sometimes wanted to sell them to somebody else.

And so merchants who were storekeepers started doing this as an extra function, and eventually they saw the desirability of getting together once a day, and they started meeting under a buttonwood tree in Wall Street at 11 o'clock in the morning to trade in these government bonds, and they formed a constitution to govern this trading. It, for example, contained a clause that they would promote just an equitable principles of trade among their members, which is still the first article of the exchange's constitution.

Well, this enterprise grew over the next 150 years and became quite large. It had many different securities listed.

As the country grew, the canals and the railroads and then the industrial companies in the last century, as they became large and needed to be traded in a central market, they were traded on the exchange, and it got to the point where the exchange was trading every security simultaneously on its floor all day long, and that is what

has been going on for the last 75 years or so.

In 1934, of course, the Securities Act of 1934 came along and gave us a somewhat different legal being, in that that act of Congress gave us a responsibility for regulating our members; you know, it became a matter of law. Previously it had only been one of our own constitutio but we carried on doing most of the same things that we had previously developed in regulation.

Now -- I guess I am taking too long -- by the time we come up to this 1968, 1969 period, we were what we had become over those years, and we were still what we had started out being, an unincorporated association of members as far as the kind of legal entity that we were then.

Q After the passage of the Securities Exchange Act of 1934, did the exchange acquire a supervisor?

A Yes, we did.

Q Who was that?

A The Securities and ExchangeCommission. It took a year or two to get organized, but it was pretty effectively functioning by the time we got to this '68, '69 period.

Q As you went about your business as the head of the Department of Member Firms did you from time to time encounter the supervision by the Securities and Exchange Commission?

A Yes. I considered that we were co-workers doing the same work.

Q I take it you in turn supervised the member firms of New York Stock Exchange?

A Yes.

Q Did the Securities and Exchange Commission do the same thing?

A To some extent. They looked over our shoulder at what we were doing and did some supervision in areas that we didn't do much in. For example, the underwriting area, they would look at what member firms were doing in that. Or if they had some reason for

doing so they might do the same thing we were doing.

Q Let me ask in common terms, Mr. Bishop, your understanding of the scheme of regulation. Could you put a member firm out of business if proper showing was made?

A Yes.

Q Could the Securities and Exchange Commission put a member firm out of business if a proper showing were made?

MR. BEEBE: Objection to relevance.

THE COURT: Overruled.

A Yes.

Q Could the Securities and Exchange Commission put the stock exchange out of business if a proper showing were made?

MR. BEEBE: Same objection.

THE COURT: Overruled.

A Yes.

Q Tell me about the exchange,in about January '69, who were members of the exchange first of all? Let's start with that.

A Well, we have people whom you probably heard about as having seats on the stock exchange. They are the members. They are individuals. By

provisions of our constitution, there are just 1366 seats.

Originally they were chairs where you sat in a room to trade. But by the time this period came along it was just the right to go on the floor physically and make a trade in the trading crowd. There were only 1366 such opportunities. If you wanted to become a member of the exchange you had to purchase this privilege from somebody else who was leaving for some reason or other.

These people were the members.

Q While you are on the subject of purchasing those seats, Mr. Bishop, do you recall what one of those seats was selling for in and about June of 1969?

A About $400,000.

Q Now, how do you get from a member, which is a live person walking around and sitting in these seats once in a while, and a member firm? What is the relationship between the two?

A If a member is associated with any securities brokerage firm, that firm has to be a member firm. And if it doesn't qualify for being a member firm, then the member has to leave it. Therefore, a member firm gets to ge a member firm first by having a member

associated with it, and second by being approved by the exchange as a member firm. In order to be a member firm it has to agree to abide by the constitution and rules of the exchange, to have all of its people subject to the regulatory jurisdiction of the exchange. We are able to put any person out of the firm with due showing. And they have to have certain types of people qualified with us in the kinds of examinations and other things that I mentioned a few minutes ago.

Q Do those people who are approved as officers or partners in member firms enter into any kind of an agreement with the exchange to abide by the rules?

A Three categories of such people do. First the members. These agreements are all similar. Second, what we call allied members. They are the other general partners or voting stockholders in member firms, in the period we are talking about. In general, these people were principal executives in the firm.

Now, it was also possible to be an officer of the firm, say a vice president, without being an allied member and a voting stockholder. But practically all the officers of the firm were also allied members.

The third category were what we call

registered representatives. They were the people who were not allied members but who service customer accounts. If you wanted to buy or sell a security, they are the ones who would give you advice on doing it and take your order, see thatit got put in properly, take care of relationships with you. They are registered representatives.

Q I take it from your explanation member firms can be both corporations and partnerships?

A Yes. Prior to 1954 they all had to be partnerships. But beginning in 1954 they could be corporations as well.

Q What is the equivalent of a partner where the member firm is a corporation?

A In this period it was a voting stockholder. We had two kinds of stock, voting and non-voting. The people who ran the firm owned the voting stock, and the people who were not in the firm or who weren't important enough for the firm to judge that they were in the top running group had non-voting stock.

Q Now, would the people who have voting stock have to be approved by the exchange?

A Yes.

Q What would they be? Would they be members

or allied members?

A They would be allied members.

Q Let me show you --

A They could also be members.

Q Let me show you Exhibit 13, which is the application for allied membership of James F. McDonnell, Jr., sir, and ask you if that is the type of agreement that you referred to before when you said an allied member agreed to abide by the rules, and so forth?

A Yes. It says so right in a little paragraph here.

Q Thank you.

THE COURT: Would this be a good time for a recess, Mr. Brooks?

MR. BROOKS: Yes, your Honor.

THE COURT: We will recess then.

(Recess)

(In open court; jury present)

BY MR. BROOKS:

Q Can you tell us the basic divisions or departments of the stock exchange in and about 1969?

A We had a floor operations department which provided the clerks and coupon men and personnel who helped members run the floor. We had a stock list

department having to do with the listed companies and listing stocks on the exchange.

Q Is a listed company something like General Motors or ATT?

A Yes. All of the companies whose stock we trade in, or bonds.

We had my department, the department of member firms. We had our stock clearing corporation which has to do with exchanging the money in securities four days after the trade is made on the floor. What we call settling the trade. I believe we had the beginnings of our depository trust company, which is now a bank subsidiary which holds customers securities in the names of the firms with whom they are on deposit. And then we had the usual kinds of things that any corporation has or any business enterprise, like the treasurer's office and controller's office and a personnel department and a building company that has the cleaning people and runs our building, and the guards.

I think they are the major ones. Maybe I have forgotten someone.

Q I think you have gone far enough for our purposes.

A The floor department then had two parts.

It had floor operations, which I described a minute ago. Then it also had floor regulations. That was a separate section.

Q We have had introduced as Plaintiffs' Exhibit 34 the New York Stock Exchange constitution and rules. Does that constitution and those rules have to be approved by anybody other than the stock exchange before they are affected?

A Well, the word "approved," I think you are correct in a sense in that they originally had to be filed with the Securities and Exchange Commission and they had to find that for certain things expedited in the '34 Act that our rules were adequate. So that in that sense they approved them.

Then beginning sometime in the late '60s, and I don't remember the exact date, we had -- well, before that we had to file any changes in our rules with the SEC once a year, we have to make sort of a resubmission of our constitution and rules at the beginning of each year with any changes.

Then sometime in the late '60s we had to start filing proposed rule changes with the SEC I think three weeks in advance of our being able to have the board of directors approve them. There was a provision

for emergency action to shortcut that procedure, but it's hardly ever used.

Q Which of the rules and which of the provisions of the constitution did you work with in supervising the member firms that you had charge of in and about January of 1969?

A Well, there are a great many. It must be about half of the rulebook which is about this thick (indicating). And up at the top of each page in the constitution and rules there is alittle line that says who is responsible for supervising the rules on that page, and on ours it says department of member firms.

It's basically all the rules having to do with the books and records of member firms, their financial responsibility, their conduct in sales activities in their offices around the world, supervision of firms, and that type of thing.

Q How many employees were there in the department of member firms in and about January of 1969 to supervise the application of these rules?

A Around 250.

Q Tell me what tools or methods you would use to supervise the average member firm that did business with the public such as McDonnell?

A Well, we had our department divided up into sections, which each had its own techniques.

Would you like me to try and cover the whole scope or some part of it?

Q Well, we have heard lots of testimony about an audit here. Why don't you start with the role that an audit played in the supervision by your department of member firms and perhaps work from there and tell us what other kinds of reporting tools or devices you had, what methods you had to inspect on your own and we will move on from there.

A I guess this would come in the area of financial and operational surveillances as contrasted to sales surveillance, which we had somewhat different techniques for.

In the area of financial and operations surveillance both our rules and the SEC's rules were parallel in this respect: that we both required that each broker-dealer doing business with the public have an audit each year by an independent public accounting firm.

We and the SEC, our rules were identical in this respect, and we each required what the auditor should do in that audit. And as compared with the

usual industrial audits, we required them to be much more thorough. They had to, for example, what we call requests for confirmation to every customer with whom the firm had an open securities account and to every broker-dealer that they had an open securities account, and to every bank for every security and every loan in the bank, and every transfer agent.

Now, in many other types of businesses, the auditor would be permitted to only send to a sampling of his own choice. He would decide how much of a sampling needed to be made.

At any rate, and maybe I'm getting too detailed, the audit was one tool and the auditor had to fill out a questionnaire based on the audit which was submitted to the SEC and the exchange.

Q Let me show you Exhibit Z, which is the report or the answers to financial quesionnaire submitted by Lybrand, Ross Brothers & Montgomery for McDonnell & Co. as of October 31, '68.

Is that the end product of the audit you have been describing?

A Yes. Do you want me to go on?

MR. BEEBE: I think he should finish his answre.

THE WITNESS: I finished it on that question.

THE COURT: Put your next question, Mr. Brooks.

Q Now, did you have any other reporting devices similar to the audit done by the accountants?

A Yes.

Q What were they?

A This came in once a year and we wanted to know more frequently similar information. So we had another form of questionnaire which the firm had to fill out itself whenever we asked for it.

Now, it was our usual practice to ask for it twice a year and we divided the year up into four-month periods. The auditors would tell us confidentially what month they were going to make their audit in or what third of the year. Then we would send questionnaires to the firm in the other two thirds.

If we wanted to we could also ask them to do it more frequently, but normally we just got three a year.

Q You mentioned that the --

A I think I should add to that that in order to have some assurance that the firm was being honest in reporting to us, we had our own staff of examiners

who would go into the firm occasionally, usually once a year, and take one of these questionnaires that the firm had submitted along with them and look at the firm's books and records and see if what was reported to us on the questionnaire was accurate.

Q Let me show you Plaintiffs' Exhibit 28, which is Mr. McElroy's report of McDonnell Company dated April 24, '69.

Is that the end product of such a visit that you described as having been part of your program and undertaken by examiners?

A Well, it's yes and no. This one, it says "Limited examination visit," is the title. It means that he apparently was not doing everything that he might have done if he had gone in on one of these routine visits.

In this case he was looking at what the auditors had reported as of October 31, 1969 --

Q '68, sir, isn't it?

A You are correct. And that he was also looking at a questionnaire submitted by the firm as of January 30, 1969. So he was looking at two of them.

Q You mentioned that the SEC's audit rule and the stock exchanges were the same or were parallel.

Does the SEC have a capital rule?

A Yes, they do. Maybe I ought to modify my previous answer a little bit. We did have something beyond what the SEC had, and that is we required the audit to be on a surprise basis at the time; the SEC did not.

Q Does the SEC have a capital rule similar to the capital rule that we have heard discussed in this case fairly often, rule 325?

MR. BEEBE: Your Honor, excuse me. I am going to object to questions about the SEC in the sense that the New York Stock Exchange is here on trial and not the United States Securities and Exchange Commission.

THE COURT: On that ground I will overrule it.

You may answer, sir.

A Yes, it's similar.

Q Does the SEC's capital rule apply to New York Stock Exchange member firms?

A No.

Q Why is that?

A The SEC's capital rule has a provision in it that allows the SEC to exempt members of national securities exchanges from the SEC's capital rule if the

SEC finds that the exchange's capital rule is -- I can't remember the exact words, but it means more comprehensive or more difficult than the SEC's capital rule.

MR. BEEBE: I should press an objection that the rules themselves are the best evidence of what the rules provide, if there are further questions along this line.

THE WITNESS: I would like to add to my answer there is a paragraph in the SEC rule that lists the exchanges that are exempted as having been found to meet the defendant, and we are one of the exchanges that are exempted as having been found to meet the test, and we are one of the exchanges listed.

Q Let's move on to the other tools that your department used in January 1969 to keep track of its member firms. Were there any other reports that a firm was required to submit on a periodic basis?

A In 1969?

Q Yes, about January, February.

A I can think offhand of two more. One was we started something called a fails report. I think maybe we started thatin 1968, which was a monthly report on a kind of incomplete transaction called a fail,

and the total number of those or total dollar value that firms had in different categories.

Then we had another report called a special operations questionnaire which gave a little bit of financial information but it mostly gave information that permitted us to estimate what the books and records condition of the firm was, whether they were in good order or not. We started that in 1968. That was required of all firms quarterly and of quite a numberof firms mo thly.

Q Can you tell me of the genesis of the special operations questionnaire? You said it started in 1968. Why did it start and how was it designed?

A How was it what?

Q Designed.

A Well, when the volume of business handled by member firms reached the point where their staffs and their systems were being overtaxed and more than normal errors started to creep into the member firms generally, we decided we needed some new technique for being more current and for identifying just which firms and in what departments of the firms unsatisfactory conditions might be arising.

And the financial questionnaires didn't give

us enough detail in that respect and they weren't frequent enough. So we assigned some of our examiners to sit down and write a questionnaire that would develop more operations type information, and that's what these special operations questionnaires were. It was written in, say, March or thereabouts of 1968 and put into use immediately.

Q What about profit and loss information from member firms, did you receive that?

A We got that once a year in what were called the income and expense reports which were primarily designed in connection with -- the exchange also established commissions which all member firms had to charge on listed securities trades,and this was designed primarily to allocate the costs and revenues of a securities firm to the commission business as opposed to the other types of business that they did.

Q I guess the principle that would be applied would be that big money makers pay the most because they have a percentage of their commission that goes to the exchange?

A You are talking about registered representatives?

Q Well, you said you want to keep track of

their commission business?

Q Yes.

A Because we had some special duties in that respect. Most businesses aren't permitted to charge the same prices that other businesses do in cooperation with the others. Macy's and Gimbels can't get together and decide to charge the same price. But stock exchange firms could, and the stock exchange set those rates with the supervision and approval of the SEC. And that is the reason that we got this information.

Q Part of your regulatory function?

A Yes.

Q Now, suppose a customer of a member firm out in DesMoines has a complaint. Can that complaint get a favorable reception at some office of the exchange?

A Yes. We had a complaint division under me where all such inquiries and complaints from customers coming anyplace to the exchange were all funneled into this division who would look into it and correspond with the customer.

Now, I guess I haven't gone quite far enough three. We also had another place. We had an arbitration facility where disputes that couldn't be readily resolved were heard by, in effect, a jury.

It's sort of a small court procedure, less formal than courts, called arbitration but authorized under New York State law for settling disputes between customers.

MR. BEEBE: Sir, could I suggest we move from DesMoines to New York and bring things a little closer to the facts at hand?

MR. BROOKS: I am just about to, your Honor.

Q Could a subordinated lender avail himself of your inquiry and complaints department or your arbitration facilities if they felt they had a grievance against a member firm?

A Yes.

MR. BEEBE: Objection to relevance.

THE COURT: How is this relevant?

MR. BROOKS: As I understand the complaint against the exchange, it's being charged with failure to properly regulate.

MR. BEEBE: In part.

MR. BROOKS: If there is a facility available which someone who feels he's aggrieved has not taken advantage of, it's relevant to that claim.

MR. BEEBE: I'm not sure how even mentioning that kind of question can pertain at all to the question here.

THE COURT: I think I'll overrule that objection.

A Yes, they could. In fact, many grievances provided that the dispute should be arbitrated.

Q Do you know from time to time that subordinated lenders do avail themselves of these facilities?

A Yes, they do.

Q Mr. Bishop, as you no doubt know there has been a lot of controversy in this case about the New York Stock Exchange capital rule, rule 325. Could you tell me what the objective of that rule is?

A Well, its objective arises from the experience of the stock exahcnge, and I think it was originally written in the 1920's and has developed since, where it really has two objectives.

One is to make sure that firms have enough cash t meet the needs of paying out customers and paying other brokers, and so forth, in the normal course of their business. We call that the liquidity aspect of the rule.

Its second objective is to bring some harmony between the amount of capital that we require a firm to have -- here I use the word "capital" as being their net worth, as we use it -- in comparison with

the risk and the kinds of business they engage in. And to give you an example of what I am talking about, if they make markets in securities and consequently buy securities and have positions in them in connection with their business, they do underwritings where they are buying security positions, we do not allow those security positions at full value as shown by the market; instead we discount them by the amount which we think they would decline under severe conditions. We call that a haircut. For common stocks like American Telephone, it's 30 per cent.

Q During this period would you be in agreement with the statement that the rule provided a maximum capital ratio of 2000 per cent from member firms?

A Yes.

Q Did the department of member firms or other responsible officers of the exchange have the authority to grant an exception to that rule?

A Yes.

Q Did the same officers have authority to make a more stringent requirement on a particular member firm?

A Yes.

Q Did you during this '68 and '69 period have occasion to make judgments in respect to what was good

capital and what was not good capital under the capital rule?

A Yes.

Q Was that unusual?

A No.

Q We have haard a lot of talk in this case about stock record differences. Can you tell me whether stock record differences would be an example of a problem on which you had to make a judgment in '68 and '69 in respect to the capital rule?

A Yes, they were that kind of problem.

Q Will you explain what the problem of a stock record difference was and what kind of judgment had to be made and what the considerations were?

A Well, whenever a bookkeeping error is made in the accounting for the securities held by a firm as opposed to its cash, that error would likely be reflected in its stock record, which I think you have heard before is a list showing on one side what stocks they are supposed to be holding for what customers and on the other side where the stocks are supposed to be.

So if an error is made, for example, if McDonnell & Company -- if I was a customer of McDonnell

and if they had mailed the stock out to me and they didn't note that in their records it would show me as still owning a stock but yet they have mailed it to me so they would be short on their records, although they weren't really short but their records would show that they needed the stock for me that they didn't have.

All kinds of errors flowed through into the stock record, and the question was whether we should impose a capital charge on a firm in respect to those errors. That was a kind of question that came up every now and then.

Q Why hadn't this question been settled long ago?

MR. BEEBE: Objection. We don't know that it wasn't settled long ago. There is no foundation for thatquestion.

THE COURT: Let's lay the foundation.

Q Mr. Bishop, I take it from your testimony that you were required to make judgments about stock record differences in '68 and '69?

MR. BEEBE: Objection. Thatwas not his testimony.

THE COURT: Overruled.

Q Is that correct?

A Yes.

Q Well, can you tell me why there had not been developed a settled practice or a provision of the capital rule to cover stock record differences?

MR. BEEBE: Objection to form and foundation.

THE COURT: Overruled.

A It came up infrequently. On the few occasions that it did come up earlier, we had made decisions which gave us an experience for the new questions that were to come.

Q Did it come up more frequently in 1968 and 1969?

A Yes.

Q Why?

A Pardon?

Q Why?

A Well, formerly the bookkeeping errors were not in large enough quantity to be significant. The stock record differences had been relatively isolated.

I can remember maybe two or three in the early parts of the '60s, but you know, I suppose a couple of hundred firms at least had large stock record differences in 1968 and 1969. It was a general industry problem.

Q Tell me what judgments you made with respect to the treatment of stock record differences as good capital or not as good capital.

A Well, our experience had been in going through these instances that we had had occasionally previously that the errors would get corrected and there would be no actual loss, so that we ordinarily did not charge short stock record differences to the firm's capital.

Q Let's try to set the scene a little better before we go further, Mr. Bishop.

Who was your immediate superior in 1968?

A Mr. Arning.

Q And who was immediately below you in the chain of command?

A In this area, Mr. Stock.

Q So with respect to McDonnell & Company, would a coordinator be below Mr. Stock?

A Yes.

Q We know that Mr. Schuette was one coordinator succeeded by Mr. Newman.

A Yes.

Q Let's suppose that a firm violates one of the rules that you have jurisdiction over, a record keeping rule or a capital rule, what did your department do in 1969 when that was discovered?

MR. BEEBE: Objection. Hypothetical.

MR. BROOKS: I am just trying to get the general practice your Honor.

THE COURT: Overruled.

A First we had to decide whether we thought it was a significant violation. With the complexity of our rules and detail it's hard for people not to have some departures from it in the ordinary course that are just normal, but if we thought that it was a significant violation then we would set about seeking to bring disciplinary action against them, which we would do by drawing up a charge memorandum

and submitting it to an appropriate body.

Q What do you do about that violation there that's in existence? Do you do anything to correct it?

A Oh, well, if it was something serious, yes, we would get it corrected first before we addressed ourselves to the disciplinary possibilities.

Q Is the violation of the capital rule such an event?

A Yes, it is, always.

Q And record keeping rules?

A Yes. It depends on the record keeping rules as how serious they were.

Q Did the rules themselves besides the capital rule provide for any penalty when there is a violation?

A No.

Q How about the record keeping rule?

A No.

Q Does it say if you have got a bad book and a bad record you get such and such penalty?

A No, it does not.

Q How does the penalty work? How do you decide who gets what for what?

A Well, there is a provision of the constitution that provides that for violations of rules, censures, fines or suspensions or expulsions may be imposed after due process.

Q What do you mean by due process?

A The same sort of thing we are going through right here in this courtroom, namely, giving the person who is said to be at fault an occasion to know exactly what he is charged with through a written charge memorandum; then giving him an opportunity to reply to it in writing; to permit him to appear at a hearing and confront the people who are charging him and the witnesses, and questioning them, just as is being done here. And then some competent body comes up with a decision just as the jury is doing here. It is the same sort of procedure.

Q At the exchange in 1969 who was the competent body that would make adjudications on these charges?

A In the case of a capital violation type of charge it was the Board of Governors of the exchange, which is the same as the board of directors; but they assigned or delegated responsibility for conducting the hearings, for being the jury, in most instances to a committee of the board called the Advisory Committee.

Q Was there any procedure whereby the exchange could avoid all this due process stuff and just put a member firm out of business with just a snap of the finger?

A Yes -- not quite a snap of the finger, but more quickly.

Q Can you tell me what provision that was?

A Well, there is another section of the constitution which provides for a summary procedure to be used in extremely serious cases.

Q Do you know what provision of the constitution that is?

A Yes, that's article 13 of the constitution.

Q What kind of a showing do you have to make to do it like that or maybe just a little slower?

A Well, the language of that section is that the board -- and here the board can't delegate it to a committee -- the board has to find that the firm is in such financial or operating condition that it can't continue in business with safety to its creditors. That means its customers.

Q Has that provision ever been exercised to suspend a member firm?

A Occasionally.

Q Let's turn our attention for a moment - and I am sure it's time we did - to the firm of McDonnell & Company:

In about December of 1968 did you have an awareness of appreciation of the character and quality of the firmof McDonnell & Company as one of the firms

under your charge?

A Yes.

Q Can you tell me what you knew about that firm then just as a matter of your own knowledge and background?

A Well, I had then been in regulatory work for eight years, and in the early stages I traveled around the country a good deal visiting member firms' offices and member firms out of town, and member firms in New York too, but I had visited McDonnell, both their main office and several of their branches in that period, and I was very well impressed with McDonnell. You know, they had the rights business on the exchange, which is very fine professional business; and I was very impressed with them as a retail organization.

I remember in Los Angeles they had co-managers who were running an excellent training program, and at the time I was working a lot on training registered representatives, and I spent a day with them seeing what their training program was about, and they impressed me as very good people, and so did the rest of the people that I met from McDonnell. They were a wide awake, progressive group of people.

Q What did you know about the capital structure? Where did it come from?

MR. BEEBE: Objection. I don't see what the

point is as to where the capital came from or didn't come from in 1968. The question is, the issues that have been hashed out here have to do with what the condition of the company was and what was happening to it.

THE COURT: Is it prejudicial in any way to you?

MR. BEEBE: I believe it may be sir.

THE COURT: Well, do you contend that it is in any way?

MR. BEEBE: I would submit, sir, that it is getting again into areas that are irrelevant and perhaps materially distracting from the major issues at hand, because it is like the Ford and other things that keep coming up which has nothing to do with this case, and are prejudicial.

THE COURT: I will overrule the objection.

A Most of their capital came from the McDonnell family, and what didn't come from the McDonnell family was mostly from other executive officers of the firm and their families.

BY MR. BROOKS:

Q Do you know who controlled the firm?

MR. BEEBE: Objection your Honor. I think that calls for a conclusion of law as well as an operation of someone else's mind as to what is control--

THE COURT: I sustain it as to form.

Q Did you know who the chief executive officer was of the firm, sir?

A Yes.

Q Who was that?

A Murray McDonnell.

Q Do you know who the chief operations officer of the firm was?

A Thomas McKay.

Q Who had preceded him in that position?

A I don't know who preceded Mr. McKay.

Q Did you know a Sean McDonnell?

A Oh, well, yes, although Sean McDonnell you might call the chief financial officer as opposed to the chief operations officer, and his main work at the time I first met him was in working on their new data processing system.

Q Did you know about the profitability of McDonnell & Company in late 1968?

A They were a profitable firm. The reports they had been submitting to us had shown them to be very profitable for the previous several years, and their profits were growing according to these reports.

Q How many customers did they have in about January of 1969?

A It could have been in the neighborhood of 60,000.

Q How many branch offices?

A 25 or 30.

Q Sir, when someone wants to become a capital contributor to a member firm, such as Mrs. Murphy became in respect to McDonnell & Company, will you tell me what functions the exchange plays in that kind of a transaction?

MR. BEEBE: Objection to the characterization. The question is hypothetical, and there is no testimony that Mrs. Murphy wanted to become what she was asked to become. It is completely a mischaracterization of the situation.

THE COURT: Rephrase it. When someone makes application to become, what happens?

Q When someone makes application to become a subordinated lender, Mr. Bishop, or did make such application in about February of 1969, how would the exchange function on that application? What would they do? What would they consider, and how would it function?

A Providing they are not already a person approved by the exhcnage we would determine whether they were the type of person that was acceptable to be associated with a member firm, and there we would look at whether or not they were a principal of another broker-dealer or a bank. We would

not lets a conflict of interest come in of that kind. But providing they were not in those activities, then if they were of good reputation and character and had resources to contribute what they were contributing, that was fine for them as a person.

The second thing we did -- and this was whether or not we had previously approved the person -- was look at the legal instruments by which they were contributing their capital and make sure that it was legally putting it at the risk of the business in a form that was acceptable from our capital rules point of view.

Q Let me show you Exhibit 3 and Receiver's Exhibit B-1, which are the subordinated agreements with Anna McDonnell in 1966 and Margaret Mary Murphy in 1969, and I ask you, was that kind of subordination agreement form generally used at about this time?

A Yes, this is one of the forms that was common.

Let me look at the other one.

This is the same.

Q Now, if the subordinated lender signed one of those and it came in to you, and the exchange were to reject that person because maybe it didn't like the character of the person, would the deal that the contributor made with these firms be a binding deal?

MR. BEEBE: Objection. That calls for a legal conclusion, and I think it depends completely on the instruments involved, and it is hypothetical on top of everything else.

MR. BROOKS: Your Honor, I think Mr. Beebe's point is well taken. I would just like to read a sentence or two from the instruments. That ought to clear the problem up.

MR. BEEBE: Which one are we dealing with?

MR. BROOKS: They are both the same.

MR. BEEBE: I don't know that.

MR. BROOKS: Let's take Receiver's Exhibit B-1. I am reading from paragraph 10.

It says:

"This agreement embodies the entire understanding of the parties hereto and shall be effective as of and from December 30, 1966, whether or not the owner is approved by the exchange."

And I believe Mrs. Murphy's subordination agreement says exactly the same thing in the same paragraph 10.

THE WITNESS: Except for the date.

MR. BROOKS: Except for the date, thank you, sir.

Q Does that accord with your recollection of the customary practices?

A Yes.

Q Now, these agreements provide in paragraph 1A that the owner can give written notice of a hundred days and at the end of the hundred days terminate the agreement.

Would that have permitted the owner to then withdraw the capital that had been contributed at the end of the hundred days?

MR. BEEBE: I would object in the sense that the document speaks for itself. There are a number of other conditions and events that can occur within that hundred days.

THE COURT: I would think that was so; is it not?

MR. BROOKS: I don't think so. I guess we argue on the terms of the agreement.

MR. BEEBE: Well, I just feel that posing to this witness that kind of question, I just feel it is objectionable.

MR. BROOKS: Your Honor, it was his function to supervise these events and approved forms such as these. I believe he does have a background to testify on the question.

THE COURT: Is there going to be something that permits a variation of a written instrument under certain circumstances?

MR. BROOKS: No.

THE COURT: Put another question.

BY MR. BROOKS:

Q When you got a proposed capital contributor such as you would when you got forms like these for your approval, and you got a person to look over and determine whether they are of sufficient character, did you give them any business advice on the wisdom or lack of wisdom in going ahead with the transaction that was put before you?

A No, we usually never saw them.

Q Why didn't you counsel them on business considerations?

A That really wasn't an area of our competence.

Q Did you counsel the member firm on the wisdom of a proposed capital contribution?

A No.

Q Mr. Bishop, I want to go back about a year to early 1968 and ask you whether you recall the arrival at the New York Stock Exchange in and about February, 1968, of a Lybrand audit report for McDonnell & Co. as of October, 1967?

A I don't recall its arrival because I don't think I knew about it until a couple of weeks after it arrived.

Q Well, tell me what you recall when it first came to your attention.

A I had been engaged putting most of my time on another project for the exchange, and when I came back to the office a couple of weeks or maybe three weeks after this report had been filed, my staff told me about it, who had been working with it in the meantime, and said that they weren't really getting satisfactory responses from McDonnell. McDonnell just didn't seem to be giving it the attention that they deserved. At least they weren't telling our staff what they were doing.

Do you want me to go on?

Q Well, can you be any more specific about what kind of problems your staff expected a response in respect to? What kind of a response did they ask for and what did they get? What was the problem?

A I think they were looking for some detailed planning by McDonnell on what they were doing about correcting the record-keeping problems that that audit showed. A plan by McDonnell for, you know, doing things better. And McDonnell just wasn't telling them much about what they were doing.

Q What action, if any, did you take, sir?

A Well, I had had --

THE COURT: When is this now?

MR. BROOKS: I established that report came in --

THE COURT: Sometime in February?

MR. BROOKS: I think I established the report came in in February. He was away for a couple of weeks in '68 and he came back to the office.

Q Where are we at, Mr. Bishop, in time?

A I can establish the date in a minute. I don't remember it, but I can remember a document that will establish it.

As I say, I was rather upset that McDonnell was not responding to my staff with more facility and I thought we probably had an example of the kind we had run into where the member firm thinks it is too important to think the exchange staff is worth having much attention.

So I decided to shock them, and I wrote a letter that has been referred to here before telling McDonnell to get over and explain things to us, and that until they get over to explain it to us we were not going to let them add any register representatives or branch offices.

Q Let me try to help you and fix the date, sir. I show you Plaintiffs' Exhibit 79, which is a letter dated March 18, 1968, to McDonnell & Co. Is that the letter that you are referring to?

A Yes, it is.

Q Was the problem that McDonnell & Company's 1967 audit had revealed to you a problem that was being encountered by other member firms at about this time?

A Yes. This was the same kind which we were writing the operations questionnaire for.

In fact, I think that I spoke in this letter about asking them to complete an enclosed questionnaire, and I think that that was the draft of the operations questionnaire which we perhaps hadn't put a name on yet.

Q Was that the first or one of the first uses of the special operations questionnaire?

A I believe it was.

Q Was that a reaction to what has commonly been called a period of the paperwork crunch on Wall Street?

A That was the beginning of it, yes.

Q Let me show you another exhibit, which is 78 --

THE COURT: Mr. Bishop, let me see that for a minute.

Q (Continuing) -- which appears to be a similar admonition to all member firms signed by you on March 14th, 1968.

Do you recall preparing and signing such a message?

A Yes, I do. I was in a flurry of activity when I

got back from this other thing, and I did this circular and the McDonnell letter and the special operations questionnaire and so forth, all at once.

Q And were those three things a reaction to the paperwork crunch?

A They were a response to it.

Q Well, what happened when you sent this letter of March 18, 1968, over to McDonnell & Company to try to get them to pay attention?

A Well, I certainly got results.

Q Tell me what happened.

A I think first I got a nice letter from Murray McDonnell saying of course they would get together the commission we wanted, and he was assigning some of his staff to do it. And then they came over and had one or two meetings with us at which they did give, you know, a pretty full presentation.

Q Let me show you Plaintiffs' Exhibit 80 and ask you if that is the letter you received from Murray McDonnell.

A No, this is a letter to Murray from me.

Q Counsel just made an error.

A This is one that I think I sent them after these meetings.

Q Let me show you what I have premarked as exchange

Exhibit KKK and ask you if that is a letter that you received from Murray?

A Yes, it is. Although this doesn't seem to be the copy I received because it is not signed. I think this was apparently a copy that came from Mr. McDonnell's file.

MR. BROOKS: I offer this in evidence as Exchange Exhibit KKK.

MR. BEEBE: No objection.

(Defendant Stock Exchange's Exhibit KKK is received in evidence.)

Q Apparently before you had gotten KKK you had had a meeting which is described in Plaintiffs' Exhibit 80, a letter that you have correctly pointed out was sent by you to McDonnell & Co. dated April 2nd. Do you recall that meeting?

A Yes, you are correct. I guess rather than my getting the letter from Mr. McDonnell first, they hurried right over and talked with us and then sent the letter. In the meantime I sent this April 2nd letter to them.

Q Well, do you recall more than one meeting at this time?

A I think so.

Q More than one meeting?

A Well, this letter reflects one meeting. I don't

think that Mr. McDonnell was at this meeting. I think perhaps he came over to see me first and then he sent this delegation of officers over to give me the detail that's reflected in this letter.

Then I'm not sure whether we had another meeting with him after this one or not.

Q Who was the delegation of officers that came over?

A Well, I think it was Sean McDonnell and Tom McKay and some others. I don't remember who the others were.

Q What positions did you understand those two gentlemen to be holding at that time?

A I think Sean McDonnell was executive vice-president and he was talking primarily about their new computer system.

Tom McKay, I guess maybe his title was vice-president, but I understood him to be the chief operations and financial officer. I had known him for quite a long time and knew what he did.

Q Let me show you what has been marked as Plaintiffs' Exhibit 81, sir, which is a letter dated April 19th, 1968, by you to Mr. T. Murray McDonnell. It refers to a good response that the firm had made on April 17th.

I ask you if that refreshes your recollection on a

subsequent personal meeting that was had between McDonnell & Company and you and your staff?

A I believe there was a meeting on April 17th, but I would suspect that they also gave us some written material then.

Let's see. Yes, later on it mentions an April 17th letter also, so that backs up what I was thinking.

Q Well, as a result of these meetings and this correspondence, sir, did you come to any determination about the restrictions that you had imposed in March?

A Yes. I really did what I had contemplated doing when I wrote the first letter. In the first letter I said that I was imposing the restrictions pending the meeting. Since I had thought then that it was probably a matter of their telling us what they were doing rather than their having to start doing something that they weren't already doing.

I had contemplated when I wrote the original letter that I might remove the restrictions if they gave us a good enough story. And they did and I took off the restrictions.

Q I note, though, that you continued to require periodic reports.

A Oh, yes. We put them on the monthly operations

questionnaire, I think, instead of the quarterly.

Q How did it go thereafter in the next few months? Did you keep watch on McDonnell & Company?

A My coordinator certainly did. I think things went relatively as they had told us they would. So that the coordinator didn't have to come back to me in the next couple of months and tell me that things were going badly.

Q Do you recall any restrictions being voluntarily applied by McDonnell & Co. during the summer of 1968?

A Yes, I do. I think I can set them with one of those letters I just looked at, if I am not mistaken.

Well, I had sent them the circular we looked at. I think I also sent with the letter some ideas for how a firm could control its own business when they wanted to hold down the size of the business. And I had sent them some ideas that another firm had developed to use itself.

Starting with those ideas that I had sent them, they applied them to their own situation and thought up some new ones of their own, and along during the summer sometime I think they formalized some restrictions of their own, circulated it to the proper people in their firm and sent me a copy.

Q Do you recall what those particular restrictions were that they adopted in July 1968?

A Not too well. But some of them were to try and control the number of small transactions and hard-to-do transactions, you know, that were more of an effort than they were income.

Q Would a small transaction generate as much paperwork as a big transaction?

A Yes. And sometimes more. For example, low-priced over-the-counter securities where there were no New York City transfer agents, maybe a company who was out in some mountain community was the transfer agent. It would take a long time to get a stock transferred, and firms tried to minimize that kind of transaction in order to reduce their paperwork problem.

Q There came a time when McDonnell & Co. sent a letter to the Department of Member Firms in January of 1969 when they had encountered some other problems. That has been marked and admitted as Exchange Exhibit BB-1.

I ask you whether on Page 8 of that January 28th letter McDonnell & Co. takes the opportunity to remind you that they are still functioning under those restrictions that you told us they put on themselves in July?

A Yes, it does. They did.

Q Do you have Exhibit 80 before you, sir?

A Yes.

Q Have those July restrictions that we have just talked about been suggested by you in Exhibit 80 when you wrote to McDonnell on April 2nd, 1968?

A Probably most of them had their origin in these suggestions. They were perhaps some that they thought up on their own. Certainly they adapted them to their own particular circumstances.

Q Mr. Bishop, McDonnell & Co. in about the summer and fall of 1968 was attempting to convert to a computer system to do their books and record-keeping, were they not?

A Yes.

Q While they were doing this, sir, did they continue to maintain their prior or preexisting record-keeping system intact?

A Yes, they did.

Q And where were the actual records of McDonnell being kept during this period of the last six months of '68 and early '69, on which system, the new computer system or the old NCR system?

A The official records were being kept on the old system, the old electronic bookkeeping system.

Q What were they doing with this new computer?

A Well, when they got part of it ready to run, they would take the same data that they were putting into the old

system and also put it into the new system and find out whether they got an accurate record out of it. What they would find is that they did not get an accurate record from the new system, so they would stop running it.

Now, in the meantime the data kept on flowing through the old system and that was the firm's official record.

You mean they would have that data in two places?

A In the testing period, yes.

Q In the new system to test it and in the old system for a backup?

A That's correct.

Q Is that what is known as running a parallel system?

A Yes.

Q Did the exchange ever make any recommendations about running parallel systems when a firm is attempting a computer conversion?

A We generally thought it was a good idea.

Q Does Exchange Exhibit BB-1, the January 28th, 1968 letter, and Mr. McElroy's report of April 1969, the first one a report by McDonnell & Company and the second one a finding by your own examiner, reflect that these systems were being operated by McDonnell & Company?

MR. BEEBE: Objection. The documents speak for

themselves.

MR. BROOKS: I think not to the inexperienced reader.

THE COURT: These exhibits are already in evidence.

MR. BROOKS: They are indeed.

THE COURT: Is there a reference in there to parallel systems?

MR. BEEBE: I think the question is asking in effect to read the two exhibits, and this witness didn't write them.

MR. BROOKS: I think the witness in his daily or in his function would have reviewed these.

THE COURT: If the exhibit speaks for itself, then there is no need for him to comment on it. If some language in it is a technical trade term I will permit him to state what his knowledge of it is.

THE WITNESS: Within that strain, this January 28th letter does indicate with fairly clear language that we are running parallel tests on the old system and the IBM 360-40. I think this other one is not quite so clear.

MR. BEEBE: I don't find that within that constraint at all.

THE WITNESS: That's what it means to me.

THE COURT: Overruled. I have limited him quite severely. Overruled.

MR. BROOKS: I think the layman might not know that the 360 system and the 240 system are record-keeping systems, your Honor.

THE WITNESS: On Page 8, my examiner's report, the big paragraph in the middle numbered 1, says exactly the same thing to me, that they have made attempts to use the new system but that they kept the old one running while the new one was being tested.

MR. BEEBE: I move to strike.

THE COURT: It may stand.

This has to do with the parallel systems you are talking about?

THE WITNESS: Yes.

THE COURT: Mr. Brooks, are you going on to something else?

MR. BROOKS: Yes.

THE COURT: We are going to stand in recess now.

Ladies and gentlemen, I am going to have to recess court at 10 minutes of 4:00. So I am going to shorten up your lunch hour a little bit. We will reconvene at a quarter of 2:00.

(Jury leaves.)

MR. BEEBE: Sir, I didn't feel it was necessary to interrupt as we were drawing to the lunch hour, but I find the way the questioning and the answers were coming out towards the end of this morning somewhat a matter of concern. I found that there was a great deal of volunteering of self-serving statements by the witness, who is apparently the major party witness on the other side.

He was testifying a good deal as to the operations of his mind in the way he testified. He used words like "guess, think, suspect," when we really should be going after facts. There was an enormous amount of leading.

Now, if the witness were a child or something like that, or if these were merely routine matters of course I wouldn't say anything, and I didn't even when it got into matters which were beyond routine matters. But I find in effect the way the examination is going, and what I am asking for is a cautionary word so it doesn't continue this way, is simply a method of having documents and interpretations and in effect summation by counsel going through a person who is sitting on the stand, instead of getting at cold, hard facts.

I am not afraid of facts, but I am worried about operations of the mind, areas where he is in effect announcing, in the way he answers, statements that are really in the area

of argument and conclusionary statements.

It is particularly troublesome when he is talking about what McDonnell & Company did or did not do. I could take as an example when he says that they reacted quickly and ran over and they were jumping to do our bidding. If he was asked a question of did you do this or that or the other and he says what he did was very adequate or perfectly adequate, I find that troublesome to have the witness testifying in that kind of conclusionary way.

I would like a cautionary word issued.

THE COURT: Mr. Beebe, also you have the right, you know, to move to strike any of that as it is going in.

MR. BEEBE: If I find it necessary.

THE COURT: You have not been hesitant about that with certain prior witnesses.

MR. BEEBE: I really should have done it more this morning and objected before it comes out, because even when it is stricken it is already issued in the open air and it is difficult.

THE COURT: That is true.

I suppose, Mr. Brooks, you can discuss with Mr. Bishop that he should stick with the facts in his answers and be responsive to your questions as possible. He does from time to time sort of want to continue talking.

MR. BROOKS: I think, though, I disagree with Mr. Beebe on the state of mind of the decision-maker of the exchange as to how he evaluates the firm's response and their condition. I believe that is very relevant. That is what this case is all about.

THE COURT: I was not asked to rule on any of those.

MR. BEEBE: Not yet, and I won't raise it in a peripheral question and answer. But I do think I should say a word about that if it comes up this afternoon.

My view of the real heart of this aspect of the case is that there are rules. The rules say what they mean and they mean what they say, and they are set there. They are set by Congress, and there is really no way to take in your mind and say what I am going to agrandize onto myself the power and somehow the competence and jurisdiction to re-interpret away those rules and say that they don't mean this in this situation, they don't mean that in that situation.

That is where I am troubled. Where it gets across the border into, in effect, changing the rules because in his mind he thought that would be a good idea.

It will have to be in the context of a particular question this afternoon, but that is the area where I am troubled.

THE COURT: I would assume, and I have been going on the premise that there is a certain minimum flexibility in these rules in order to make them operable under circumstances that nobody could foresee. As I remember the Congressional history of this, they wanted the exchanges to have a certain flexibility in their administration.

MR. BEEBE: I am not quarreling or suggesting rigidity to the point of a solid steel door. But I am saying, your Honor, that there comes a point, and it comes rather quickly in the case of Rule 325, when flexibility or some other word like it becomes in effect changing the rule. That is all I am saying.

THE COURT: I have formed what I suppose is more or less of a clear conclusion that whether you do agree with the speed with which they acted, the exchange distinguished very sharply between record-keeping problems and 325 problems because the 325 problems they acted with substantial dispatch. Whether it was a couple of days in '68 or a couple of hours, as somebody said, in the early sixties, that one they didn't temporize with. On the other hand, they did temporize with record-keeping problems over some substantial period of time.

Dempsey-Tegler, according to the way I read that opinion, as you winnow your way down to the bottom of it,

they seemed to have carried 325 violations for as much as several months, if I read that correctly. The trial judge found that that was not an unreasonable act on the part of the exchange.

MR. BEEBE: As I pointed out the other day, sir, there it was with much more disclosure to the people who were at the other end.

THE COURT: Passing that question, still he did not find the 325 violation response was other than measured and within discretion.

MR. BEEBE: The context didn't come up. It didn't come up and wasn't argued there because it was a different question.

MR. BROOKS: Your Honor, I was there and I argued that question. I can tell you it was argued.

THE COURT: Then it didn't get ruled on.

MR. BROOKS: I think it did.

MR. BEEBE: On the speedy response argument, sir, it seems to me to quickly run out and raise money and not follow through. Putting aside the operations side, the money side continued horrendously. The only reason and way, as I have tried to show through all the evidence, and I believe I would refer to the whole transcript and all the exhibits on these points, the only way they kept the

place alive was by continuing to fool around with the rule.

THE COURT: Let me ask you something, now that I have you here for a second, Mr. Beebe, because this has been very troublesome to me and my law clerks and I have been in substantial debate for hours over the subject. Do you contend -- and I'm looking at Exhibit 86 -- do you contend that other than normal application of the rules, and remember you cited to me yesterday the arbitrage decision was other than a normal application. Do you contend that other than normal is to be equated with unreasonable in terms of regulatory discretion?

MR. BEEBE: Let me first say that all of the exchanges that we have had, as best as I can do as I stand here and not by any means waiving or limiting anything else that is in the record or the exhibits, and what have you, I contend, and the plaintiffs contend, that the whole record shows a pattern that amounts to failure to enforce the rule.

THE COURT: Unreasonable, that is what you have to get down to.

MR. BEEBE: I would submit failure to enforce is per se a violation of Section 6, and I think that's what Congress said.

THE COURT: Let me keep you with this word

"normal" because Exhibit 86, as you said yourself, is the capstone and, frankly, is the high water mark of your position.

MR. BEEBE: Since then I have had some more capstones.

THE COURT: Do you contend that an other than normal application of the rules is per se an on a reasonable application?

MR. BEEBE: I will put it this way, and I think this is a fair way to put it: If you fail to enforce the rules, and I mean in a serious respect --

THE COURT: In a normal way.

MR. BEEBE: If you don't enforce them, and I don't mean in a deminimus 2,001 sense, but where you are well over the rules, and I am not going to try to lay them all out here, but where you just fail that is a violation of Section 6 and that is a failure to enforce under Section 6 and that is recoverable by people in our position.

THE COURT: I take it that the language in 86 having to do with normal application of the rules, you do not draw from that language the conclusion that that means an unreasonable application?

MR. BEEBE: What I draw from all of 86 --

THE COURT: No. Please just stay with that.

Either yes or no to that. The language is normal application of the rules in 86. You know where I am talking about.

MR. BEEBE: I know.

THE COURT: You say if you do not have a normal application of the rules, that that application is unreasonable?

MR. BEEBE: In this case, yes.

THE COURT: You can conclude from the use of that language that that exhibit speaks of an unreasonable regulation just on its face?

MR. BEEBE: I conclude from that and everything else that the rules were not enforced as to McDonnell & Company.

THE COURT: Now, will you go over to the next page, about the exchange allowing continued operations under increased regulation pending a scaling down of business, et cetera, when do you contend that that continued operation under increased regulation began? Is that sometime in April when we have that memo of Mr. Schuette with all the handwriting on it?

MR. BROOKS: That is in November, your Honor -- no, no. I'm sorry. April I mean.

THE COURT: This is the one that has a typewritten thing on the top and there are six or seven things down

below. I think that is April.

Is that when you contend the operations commenced under increased regulation?

MR. BEEBE: I think there is a lot of self-serving material in this. That isn't really one of my contentions. It is sort of like when did I start beating my wife before I stopped beating her.

I am not contending they didn't regulate properly at some point. It is just the contrary, that they didn't regulate properly.

Perhaps I have not made it clear. This is a malfeasance of the exchange's regulatory duties.

THE COURT: You have an exhibit that is in here as an admission against interest of the stock exchange and you are trying to hoist the stock exchange on its own language.

The question is what do you contend that language justifies? Does that justify a jury finding that starting at some point they allowed continued operation with increased regulation pending a scaling down, et cetera? Does that period start in April of '69 when the regulations began, according to your contention?

MR. BEEBE: I hadn't really focused on that language, sir. As I look at it right here, I would find it

self-serving.

THE COURT: But you used it for a purpose.

MR. BEEBE: I didn't use that language.

THE COURT: You are not drawing any conclusion from that language?

MR. BEEBE: As I read it now I would put that as sort of a defensive language on their part. They were saying that they were increasing the regulation and, therefore, they were kind of justified in what they were doing. That is my reading of it. I don't happen to agree that the evidence in the case shows that.

THE COURT: You are not drawing any conclusion from it?

MR. BEEBE: As I stand here right now I don't.

THE COURT: I was tying that together with the statement in some interrogatory that your contention was that certainly at one time and as an alternative they should have put them out of business and that would have saved everybody all that money.

MR. BEEBE: We are not holding a hundred percent to all prior contentions that may have been made and answers to interrogatories. I should make that very clear that I am not saying on a given day in January the exchange was absolutely compelled to come in and slam the door shut

and do, if you will, an Ira Haupt. I think we have gone through all the things they didn't do and gone over that area quite a lot.

Can I think a little more about that language, sir?

THE COURT: Yes. I am sorry to have cut into your lunch hour.

MR. BEEBE: My pleasure.

(Luncheon recess.)

(Continued on next page)

slh 1 Bishop-direct

AFTERNOON SESSION

1:45 P.M.

(In the courtroom in the presence of the jury.)

R O B E R T M. B I S H O P, resumed.

DIRECT EXAMINATION CONTINUED

BY MR. BROOKS:

Q Mr. Bishop, before we went to lunch I think we mentioned restrictions that McDonnell had adopted for themselves in July of 1968.

Let me ask you what the Department of Member Firms was learning about the condition of McDonnell throughout that 1968 summer. Can you give us a summary of what the situation was as you knew it?

A I believe that McDonnell was with the exception of their computer conversion doing substantially what they told us they would do - cleaning up the batches of errors that they had on hand and bringing their current work into current condition.

Q Were they submitting these special operations questionnaires on a timely basis?

A Yes, they were.

Q Now I believe the evidence shows that the audit by Lybrand Ross for the 1968 year commenced in about

October 31, 1968, and is of that date. Up until the commencement of that audit were there any factors that came to your attention of a negative nature with respect to McDonnell & Company?

MR. BEEBE: Objection your Honor. That is unbelievably conclusory.

THE COURT: Well, I will sustain the objection on the grounds of form, although I can conceive of the area you want to get to. It is a question of how to get to it. Try some other way.

BY MR. BROOKS:

Q Let's take the period from April to October of 1968, and at the end of October, the commencement of the Lybrand audit.

During this period did you have reported to you or learn of any factor which would have caused you to consider to reinstate these restrictions that had been listed?

MR. BEEBE: That is leading on top of everything else.

THE COURT: Overruled.

A My staff was under instruction to report to me any major negative things that came to their attention about firms, and I don't believe that any such matters

concerning McDonnell were reported to me in that period. Consequently I believe we received none.

Q Are you familiar with a discussion that had been going on between McDonnell & Company and exchange staff members within the exchange staff itself on the question of how to treat McDonnell's, certain of McDonnell's rights positions under the arbitrage provisions of Rule 325?

A Yes.

Q Let me show you a handwritten memorandum which appears to be authority by Mr. Newman, which I premarked as Exchange Exhibit LLL, and ask if you can identify that as Mr. Newman's note.

A This is Mr. Newman's note.

Q Do you recall his handwriting?

A Yes.

Q Do you recognize the date, the receipt stamp thereon as a stamp that would be applied at the Department of Member Firms?

A Yes.

MR. BROOKS: Your Honor, I offer this as the next exhibit in evidence.

MR. BEEBE: I object. I don't see any foundation for linking it with this witness on the recognition of handwriting and a stamp. We had Mr. Newman here.

This seems to refer-- do you have a copy, sir?

THE WITNESS: Yes.

MR. BEEBE: Well, the first sentence refers to something, as you can see, sir, and I am not sure whether it is supposedly attached to this or what it is, but Newman isn't here to testify.

MR. BROOKS: I would be glad to read it, your Honor.

MR. BEEBE: No, I don't think you should read it until it is in evidence.

THE COURT: What was the question?

(Question read.)

THE COURT: On that foundation I will sustain the objection.

MR. BROOKS: Your Honor, are you aware that he has identified Mr. Newman's handwriting?

MR. BEEBE: I'm sorry, was that earlier?

MR. BROOKS: Yes.

MR. BEEBE: That may be an identification of Mr. Newman's handwriting, but that certainly doesn't lay a foundation for this witness.

THE COURT:It doesn't tie him in. That is my problem.

MR. BROOKS: Can you read that sentence, your Honor?

THE COURT: I can, but the question is, does that

refer to anything that has anything to do with this case?

MR. BROOKS: Can I ask him if the memo as a whole refers to the case?

THE COURT: Absolutely.

BY MR. BROOKS:

Q Mr. Bishop, does this memorandum relate to the arbitrage of rights question that has been discussed from time to time?

A Yes, it does.

Q Do you see the first sentence --

THE COURT: How come you know that?

THE WITNESS: I know it from knowing the file on this subject, and this is part of the file and that subject. It was part of an exchange of documents between staff members which eventually came to me.

Q Did the entire file come to you?

A Yes.

Q Was this document in that file?

A Yes.

MR. BEEBE: I press the objection. Mr. Newman was here, and it seems really a strange way to do this. The rule that was applied to me was that the man had to be on the stand and it had to have some connection with the witness before I could get that document in.

MR. BROOKS: The witness said he read it when the file was presented to him.

MR. BEEBE: Well, that would take in everything on the New York Stock Exchange, I suppose, if he read it yesterday.

Can't we just examine the witness as to what he knows? That is really what I am getting at.

THE COURT: Yes, I am going to sustain the objection. I don't see where it carries us, for one thing. It may be the basis of a conversation he had with somebody on the subject, but the exhibit itself does not seem to possess relevance to our issues.

MR. BROOKS: The note suggests alternatives--

MR. BEEBE: Your Honor, could we have this at the side bar so we don't collaterally get the note before the jury if it is not coming in evidence?

THE COURT: I guess we better have it.

(At the side bar.)

MR. BROOKS: My point is, your Honor, Mr. Beebe has made a lot of the fact that the low level staff members who are faithfully doing their job and making recommendations, and these recommendations were turned down by higher management for some reasons, and he shows suggestions by Mr. Newman just like this that maybe we have

a change of capital rule to accommodate McDonnell. This is a note by Mr. Newman which suggests two alternatives to treat this problem. One is to carry the accounts on a trade date basis.

The witness, if permitted to testify, I think will testify that that was the alternative that was essentially followed, and that rather than the higher ups acting contrary to the recommendations of low level employees, that this was in accord with a suggestion of a low level employee as a way to handle the arbitrage of rights questions.

THE COURT: Who was this addressed to?

MR. BROOKS: Mr. Waterbury, who was the assistant chief examiner from Mr. Newman.

MR. BEEBE: The problem I have with this witness now is that the witness as he sits on the stand can testify that they did not follow the suggestions of the lower people or did some other arbitrage thing. That is his testimony. Mr. Newman was here. We could have cross-examined Mr. Newman.

MR. BROOKS: I don't think I have to try my case the way Mr. Beebe wants me to do it.

Isn't this a business record of the exchange kept in the normal course of business?

MR. BEEBE: I think on a self-serving basis--

MR. BROOKS: What has that got to do with a business record, Mr. Beebe? You can refute it on cross.

These were made available to Mr. Beebe. This notation on it is by his predecessor.

MR. BEEBE: That is not the point. The point is whether it is admissible here.

Why don't we just go through a witness? We have got a witness here.

THE COURT: Mr. Brooks, isn't the bottom line that this man is going to say that as an alternative for handling arbitrage there were certain possibilities and they reached a certain conclusion?

MR. BROOKS: But I think it is important that those alternatives were many recommendations of the lower staff, because Mr. Beebe tried to develop the theses that lower staff was doing the right thing and upper management was rejecting them. He said he got a file on the arbitrage question for his consideration, and this was among the documents.

MR. BEEBE: As I read this, Mr. Newman was told by someone, "Give me some suggestions as to other ways to do it," and he says, "I don't see any way out except for the suggestion made by WEJ" -- which is Jones, who is

also not here --

THE COURT: If he is prepared to show that he considered this memorandum among other items in the fall in reaching that conclusion --

MR. BROOKS: I think you said that already.

THE COURT: -- then I will permit it.

MR. BROOKS: I think Mr. Arning testified it was his decision, but I think Mr. Bishop will testify he was part of the decision making process. Mr. Arning was the final decision maker, as Mr. Beebe brought out.

THE COURT: I will permit it on that basis.

(End of side bar discussion.)

(In open court.)

BY MR. BROOKS:

Q Correct me if I am wrong, Mr. Bishop, but did you testify that this letter came to you in a file or that this memo came to you in a file with other documents about the arbitrage problem?

A Yes. It was not a file at that point; it was just a collection of the background to the matter coming up for me to look at.

Q For what purpose was the matter submitted to you?

A To get my opinion, I think, on how I felt about it or for passing it along to Mr. Arning, I am not sure which.

Q Did you read the memorandum which is Exhibit LLL at the time the file was sent to you?

A Yes.

Q And did you have any discussions with Mr. Arning about the problems of arbitrage?

A Yes, I did.

Q Were your discussions with Mr. Arning based upon, among other things, a file which had been presented to you?

A Yes.

MR. BROOKS: I now offer it in evidence.

THE COURT: It will be received.

(New York Stock Exchange Exhibit LLL received in evidence.)

MR. BROOKS: May I read it to the jury, your Honor?

THE COURT: You may.

MR. BROOKS: It is a note on the memo headed George H. Newman.

It is addressed to L. Waterbury.

"This chestnut is up again. I don't see any way out except for the suggestion made by WEJ that the rule be changed or that McDonnell carries its accounts on a trade date basis.

Do you agree? Over."

On the next page it says: "Perhaps Elmer Chesney has some ideas."

Initial of Mr. Newman.

BY MR. BROOKS:

Q Who was Mr. Waterbury?

A Mr. Waterbury was the assistant chief examiner of the exchange.

Q Mr. Newman we know.

Who was Mr. Chesney?

A He was the chief examiner.

MR. BEEBE: May I just correct one thing on the reading. I didn't at the end of the first page it was read: "Do you agree?"

It really is" Do you?"

MR. BROOKS: It is not altogether clear, your Honor--

MR. BEEBE: I don't see the word "agree."

MR. BROOKS: You are probably right.

Q Mr. Bishop, did you counsel or discuss with Mr. Arning this problem before you made the decision on it?

A Yes.

Q That decision which he made, did it follow either of the alternatives that are set forth in this memorandum?

A In a sense.

Q Which one?

A The trade date basis.

Q Now, can you explain to me how the question was determined and how it relates on a trade date basis so that both I and the jury can understand it?

MR. BEEBE: Is this a question that goes to the process of the decision maker?

THE COURT: No. What is meant by carrying it on a trade date basis.

MR. BEEBE: No objection.

Q Maybe we ought to back up to make sure we have the question in mind, Mr. Bishop.

What was the problem? What did McDonnell want and what was the issue?

A Well, I will explain trade date basis in the process--

Q Can you first explain the problem?

THE COURT: Yes, go back to the problem.

Q What is that issue here? Does it have something to do with Rule 325?

A Yes.

Q Does McDonnell want capital credit for something that the exchange is not sure they ought to have?

A They want the absence of a capital charge for something.

What is that that they want the absence of a capital charge for?

A As the rights specialist on the exchange they sometimes buy rights to subscribe to a stock, and at the same time sell the stock itself. What they can do is take the rights and send it into the company with some money and get some stock, which they can then deliver against the sale they have made.

Now, the reason they do this is that there is a small difference between the price of the rights and the price of the stock, and maybe they are able to make 12½ cents a share in doing this transaction.

They do both of these at approximately the same time on the floor of the exchange, so that's called an arbitrage, and normally there is no capital charge in respect to it because there is no risk. You have bought the rights and you have sold the stock all within a few minutes.

Now, normally both of these transactions settle; that is, the money and the shares are exchanged between the parties involved four days later in our stock clearing corporation.

However, rights expire on a certain day. Usually they are only good for a month or two months or three months,

something like that, and then they expire, they come to an end. The stock keeps going. So in the last four days before the rights can expire, the time to settle them gets shorter. You don't have four days left.

So the exchange trades in the rights in a different way in those last four days. The trade in what we call for cash, which means that on the same day that the trade is made the money and securities are exchanged between the two firms involved.

Now, meantime while the rights are being settled on the same day, the stock that has been traded on the same day doesn't settle until four days later, and it was this phenomenon which recurred with McDonnell because oftentimes the expiration of rights were at about the same time as having to hand in a capital questionnaire because they oftentimes came at the end of the month, so it recurred with them as a problem, and they thought that it was unfair for a capital charge to be made because they had a position that hadn't settled for four days. Now that is called the settlement date basis of bookkeeping.

There are two basic methods of keeping books for a securities firm in this respect. Most all firms keep their books on a settlement date basis, which means that they don't officially enter a trade on their books until

the settlement date. So that it reflects in their capital computation not until the settlement date.

Now, a few firms keep their books on a trade date basis, which means that they make the official entry on their books on the same day that they trade.

The bookkeeping rules generally contemplate keeping your books on a settlement date basis, but in those few instances where firms do it on a trade date basis, special approval has been given for that by the exchange and the SEC.

Now, we sometimes have come to instances where firms normally keep their books on a settlement date basis, but for a particular series of transactions we have permitted them to consider it on a trade date basis, and this was one of those kinds of things going on.

There is another one going ontoday at the New York Stock Exchange, and there were stories about it in both newspapers this morning about the American Telephone warrants-

MR. BEEBE: Sir, could I interject and object to this question? I also find the telephone warrants interesting but not particularly pertinent.

THE COURT: Let's not get into that. As I understand it you are saying, what you and your colleagues were discussing were the last four days in connection with rights, you were discussing permitting McDonnell to keep its books on a trade date basis.

THE WITNESS: In a sense, yes.

THE COURT: And that would mean they would not have, in effect, an open account upon which stock was due.

THE WITNESS: That they would not have a long position in the stock that had not yet settled.

THE COURT: And to the extent that theywere long in that, that was a capital charge against them under 325; right?

THE WITNESS: Yes. And since they had offset it with the opposing transaction, we ruled they did not have a capital charge.

THE COURT: I take it from what you said earlier that in certain instances there had been situations in which you had permitted books to be kept in whole or in part on a trade date basis?

THE WITNESS: Yes. There was another American Telephone offering of the kind that's going on now about 1962 in which we had done it. There was Studebaker-Packard when issued in the early '60s, and we had done it on specific instances where firms had some special kind of thing going on at other times.

We also permitted it in at least one member firm that kept their books on a trade date basis.

Most --

THE COURT: I think, Mr. Bishop, you had better see what the next question is that's forthcoming.

Q Mr. Bishop, let me show you a copy of Exhibit 35A, which was introduced by plaintiffs. I ask you if you recall having seen that document and indeed authored at least part of the first page of it?

A Yes, I wrote the top part ofthe page.

Q And that is, if I might just describe it for the jury, it's a note from you to Mr. Schuette making some remarks about information you have learned about McDonnell & Company, and below that a note back from him making a reply.

The first sentence of your note reads:

"I am told that McDonnell & Company has lost severl VP's (seven or eight) since the death of

Sean McDonnell."

Let's just take that sentence. Did you know anything more about the information that had come to you in respect to who those VP's were?

A I thought they were producing vice presidents.

Q What's a producing vice president?

A Well, basically the same as a registered representative. People who primarily spent their time in serving customers' accounts, being branch office managers, things of that kind.

Q In the language of the trade, Mr. Bishop, is a producer the equivalent of a business getter?

A Yes.

MR. BEEBE: Objection, leading.

THE COURT: Overruled.

Q If you had a back office problem, Mr. Bishop, would elimination of seven or eight producers help or hurt the back office problem?

A It might help in reducing the amount of business.

Q Now, you go on in your note to say:

"In addition McKay is in poor health and the man they hired to relieve him has left the firm. Their operations and control is therefore said to be

declining rapidly. Please give me a report on how the latest information we have looks in comparison with the period in which we restricted them."

Let's analyze that for a minute, sir. What was the period in which we restricted them which you referred to in the note?

A It was the period I spoke about this morning I think back in April, where for two or three weeks we had had them on restriction.

Q Now, did Mr. Schuette respond to your request for information?

A Yes, he did.

Q Is that information summarized in his note below and attached in various schedules that are part of Exhibit 35A?

A Yes.

Q What do you recall Mr. Schuette's conclusion was for any action or decision in respect to the problem that you had raised?

MR. BEEBE: Is this apart from the note itself which we have in evidence?

THE COURT: I assume so.

MR. BROOKS: The question was what do you recall.

A My recollection is that Mr. Schuette told me, as well as giving me this note, that he didn't really see any basis in what we had been receiving for the report that I had heard that McDonnell was declining; that, however, since the audit was going on that we would have something definitive on that as soon as the audit was finished and let's wait and see what it shows.

Q Mr. Schuette attached some supporting schedules to his memorandum. Did you review those supporting schedules?

A Yes, I did.

Q And as a result of the review that you made did you find anything which causeed you to think the condition of McDonnell & Company in about November of '68 was worse than it was in March of 1968 when you restricted them?

MR. BEEBE: Objection, what it caused this man to think or didn't think I don't see is relevant. The document speaks for itself. We are not here testing the mind of Mr. Bishop in 1968, November.

THE COURT: The question is whether the response was reasonable under the circumstances. Overruled.

MR. BEEBE: It caused him to think is the

way the question was phrased.

THE COURT: I think I understand. Overruled.

A I agreed with Mr. Schuette's analysis of these figures that in January it looked better than it had at the time we had them under restriction.

Q Can you be any more specific, sir? What particular factors were about the same or better? Was there anything worse in there, if any?

A Mr. Schuette on page 2 of his notes listed six areas which he then backed up with schedules, so the figures that had been submitted on the front, the operations questionnaires and which had been subjects in which they were weaker back in the spring, and the figures in the schedules support what his conclusions were here, that error accounts were better by August. That as to stock record differences he pointed out there hadn't been any complete count made but the previously known stock differences had been greatly reduced; that something called DK fails were down but they were not completely cleaned up yet; that the record keeping on the customer accounts, which is a very important area, was being kept current. They were not lagging behind on that; that suspense accounts, which are

another important indicator of errors, were down to small amounts, $7000 on four items; and that dividends were still a problem.

MR. BEEBE: The words are "a large problem." If we read from the exhibit we should read all of it.

Q Is the word "large" there?

A Yes, the word "large" is there. Let's look at the schedule and see what it says.

MR. BEEBE: May we read the exhibit?

THE COURT: He is not reading the exhibit. He is giving what he was caused to conclude from looking at it.

MR. BEEBE: I guess my objection is that it does sound like reading from the exhibit.

THE COURT: I didn't get that feeling.

A I think I concluded from what Mr. Schuette had given me that the dividend problem was no worse than it had been, but the firm did not have a good plan for correcting in that area.

Q Did not have a good plan?

A That is correct. That was always the last area thatyou were able to correct. You would get everything else in order before you could solve the

dividend problem.

Q Does the memo contain any information on the capital ratios?

A Yes.

Q Is there any problem indicated in the figures presented with respect to the capital ratio?

MR. BEEBE: I pose the same objection. It's asking him to read out of the memo.

MR. BROOKS: I am asking him to interpret it, your Honor.

THE COURT: I take it this is a comparison of this memo with the period of restrictions in early '68 and what he concluded with regard to the direction the company was going in.

Am I right in that, Mr. Brooks?

MR. BROOKS: That is correct. I believe Mr. Beebe developed that line of inquiry in his examination.

THE COURT: Overruled.

A The latest capital figure was slightly lower than the capital ratio figure had been back in March and April. It was 1369 per cent.

Q Now, you did receive some later information, I believe, Mr. Bishop, and I show you Exhibit MMM and

ask you if you can identify that for me?

A Yes. This is a special operations questionnaire filled out by McDonnell & Company as of December 31, 1968, and also showing information that they had presented to us the month before as well and information that they had presented to us as of March 21, 1968 and received by us in January. Although we received tis form in January the information as of November and March we had received earlier on other reports. It's just repeated here.

Q You are receiving the December 31 information for the first time?

A That's correct.

Q Can you tell me when you received this document?

A January 15, 1969.

Q How can you tell that, sir?

A Our date stamp, receipt stamp of the chief examiner appears on the upper left.

MR. BROOKS: I offer it in evidence, your Honor.

MR. BEEBE: My first problem is that I don't see the telltale note on the bottom of the page indicating thta it was previously produced.

Was it previously produced? Can you make a representation as to that?

MR. BROOKS: I can. I can say that all operations questionnaires to the extent they existed were produced for counsel for the plaintiff. This is one of them.

MR. BEEBE: May I just have a minute to look through it, your Honor? It was not made available.

THE COURT: Surely.

(Pause)

MR. BEEBE: On counsel's representation I have no objection.

(Defendant Stock Exchange Exhibit MMM was received in evidence.)

Q Mr. Bishop, we have looked at 35A, which was written as of November 7th. As I understand your testimony this document indicates the condition of the firm at two subsequent dates, November 30, '68 and December 31, '68; is that correct?

MR. BEEBE: I object to that as leading and also as a mischaracterization of what the document says. Let the document speak for itself as to what it does and doesn't do, I submit.

MR. BROOKS: Isubmit there is a certain amount of interpretation that can be applied to this to make it understandable.

MR. BEEBE: NOt by counsel. That's my objection.

THE COURT: We have to get at it somehow.

Q Do you have the question in mind, sir?

A I lost it exactly.

MR. BROOKS: Read it back, please.

(Question read)

A It's slightly inaccurate in that -- let's see, did you say November 7th was the last?

Q 35A was information written on November 7th or slightly before.

A Your statement is accurate, correct.

Q Now, you have told us about your conclusions after you had considered 35A at the time that it was presented to you. Did the receipt of this special operations questionnaire show youanything to the contrary of the conclusions you reached after you read 35A?

A It had a hint of something in addition.

Q Tell me what the hint was.

A Well, in the next to the last page it gives some figures for difference accounts which a footnote

says, I think -- let's see. It's in "D, stock record differences," a footnote says, "Differences reported by their auditors who were in the process of typing their report."

So that there aresome figures in the December column, there are none in the November column that give us a hint of what the audit is beginning to show.

Q What does it mean when an audit shows differences?

A Whenthe auditors originally try to balance the stock record, the list of the customers who own versus where the securities are there are normally errors just made in the counting of them. Some of the auditors' personnel get names of securities mixed up and count them wrong, and so forth. So that normally when you first do a count you have a fair number of fairly large differences. Then they start researching them to find out whether they made errors. When they eliminate all of their errors, then what's left they start looking to see how did the firm make these errors.

In the process of doing that, by the time the auditors are finished the numbers are usually cut down quite a bit.

As I understood this questionnaire they were

telling us what the auditor's figures were as of December 31 and not what the auditor would be finally reporting to us.

In other words, they were in the process of this research to find out what errors they made.

Q Are these problems of concern, the numbers of this size in respect to stock record differences at this time in an audit?

A No. And furthermore, the relationship of the numbers is favorable in that they had long differences of $9 million and short differences of a million three.

Now, that means that the predominance of stocks that they looked as though they had on hand, which they didn't have any owner for, and therefore it might belong to the firm, was far larger than the opposite, more worrisome side of stocks that appeared to belong to customers that didn't appear to be on hand.

Q Mr. Bishop, take a look at the front page again of this exhibit. You see where the column is headed "Previous month end as of November 30, 1968"?

A Yes.

Q Would there have been a special operations questionnaire submitted as of that date about a month earlier showing that information?

A Well, if we could be sure that McDonnell was giving monthly operations questionnaires, yes. But if this was a firm that was only giving quarterly ones, then we would not have gotten it but it's my impression that we did get monthly ones in this period.

Q I believe we looked at an exhibit this morning which you put that requirement on the firm in the spring: do you recall that?

A Yes. And I don't believe we listed it. So I think we should have it for November also.

Q Now, we come to the audit. We have the special operations questionnaire on about January 15th, according to the date stamp. I believe the audit was received at about that time. It was late, wasn't it?

A Yes, it was.

Q Had there been requests made for an extension?

A Yes.

Q When would it have been due under the normal rule?

A December 15th.

Q I show you a letter that has been previously marked as Stock Exchange Exhibit DD and ask you if you have seen that letter before?

A Yes, I have.

Q Can you identify the letter for me?

A When a firm requested an extension, or their auditors did, on completion of an audit and the filing of financial questionnaires, the stock exchange gave the auditors four questions to answer, and thisis the answer to those four questions.

Q Who devised those four questions to be answered by auditors when they were seeking extensions on behalf of their client?

A Did you say devised?

Q Devised.

A I did.

Q Do you recall having seenthis letter on or about December 23 or 24, 1968?

A Yes.

Q Was it furnished to he stock exchange?

A Yes, I believe it came in with the letter of McDonnell requesting an extension.

MR. BROOKS: I offer this as the next exhibit in order, your Honor.

MR. BEEBE: No objection, your Honor. Was it two D's or three D's?

MR. BROOKS: Two D's. It had been marked earlier.

(Defendant Stock Exchange Exhibit DD was received in evidence)

MR. BROOKS: I would just like to say for the record that the document I referred to a little while ago in which Mr. Bishop imposed the monthly requirement for an operations questionnaire was Exhibit 81, in case counsel needed that.

Q Now, Mr. Bishop, what was the purpose of the four questions that you devised for letters such as these?

A Well, we wanted to get some assurance from the auditors that the reason for their delay was something reasonable and that they weren't discovering some terrible events at the firm that were being withheld from us while they continued working.

Q Any terrible events disclosed in Exhibit DD?

MR. BEEBE: I believe it speaks for itself. I object to that question.

THE COURT: I think if you have phrased it to any events as he regarded as beingterrible.

MR. BROOKS: I will adopt your Honor's suggestion.

A I would say just the opposite.

Q What is just the opposite?

A That we were reassured. You know, all of the answers to the four questions were the kind of answers that we would look for in giving favorable consideration to a request for an extension. We would have said yes based on this kind of letter, and I think we did.

MR. BROOKS: Your Honor, I would like to read a passage of it, if I may, to the jury.

(Portion entitled "Capital" of Defendant Stock Exchange Exhibit DD in evidence was read to the jury)

Q Mr. Bishop, were requests for extensions to file an audit normal at this time?

A Yes.

Q Was more than one request normal?

A Yes.

Q Was that true the preceding January or February?

A Of 1969?

MR. BEEBE: Objection to this line of questioning.

THE COURT: Overruled.

Q That would make it the preceding January of 1968, about a year before.

A That is when it began to be more common than it had been previously.

Q Now, do you recall what the results of the audit were?

A That we received in January 1969?

Q Yes. Let me put that before you, sir, so you are sure of what I am speaking. I show you Exhibit Z.

A I believe that our analysis of this audit report indicated a capital violation by McDonnell.

Q Do you recall how much the violation was?

A I believe that by the time we looked at it for a week or so we thought that they were about a half million dollars, a little less than a half million dollars short. I don't remember the ratio. I know we hassled around about it for a while. But our initial firm determination was a little less than half a million dollars.

Q To regain compliance?

A Yes.

Q Do you recall a meeting at the exchange about January 29th with the principals of McDonnell to discuss the audit?

A Sort of. Yes, I guess.

Q Let me just show you a letter that is dated on the 28th, Exhibit BB1, and ask you if you recall having received that letter before your meeting?

A I remember this letter.

Q What --

A I wonder if we didn't have some meetings even before this letter, but maybe we didn't.

Q Could you summarize what McDonnell is doing in that letter?

MR. BEEBE: Again, sir, objection.

THE COURT: I think it does speak for itself.

Q Do you recall at this time that McDonnell proposed that it adopt self imposed restrictions?

A Yes.

Q Does that letter set forth the self imposed restrictions?

A Yes. They are listed beginning on page 5.

Q Would there have been or were there any other restrictions that you felt appropriate to apply to McDonnell at this time as a result of the audit report and the other information you knew about the firm?

A No.

Q Take a look at page 1 of Exhibit BB1, Mr. Bishop. Does that page --

A Which one?

MR. BEEBE: It's in your hand, sir, I believe.

Q Does thatpage reflect the withdrawal of any capital funds from McDonnell & Company by a voting stockholder?

A It reflects some what is to be withdrawn.

Q About how much, exactly how much?

A $405,000.

Q Does it reflect any additions to the capital of Mc Donnell that had been made or would be made?

MR. BEEBE: Objection, your Honor. It reflects what it reflects.

THE COURT: I have a feeling this is a foundation to go on to something else. I will overrule that objection.

Q Did we get an answer?

A One and a half million dollars.

Q Are there other subtractions and other additions shown to have been made to the capital of McDonnell on that first page between the audit date of October 31 and the date that the letter is written?

A Yes.

Q How does it net out, Mr. Bishop? Is there a net gain to the capital of McDonnell or a net loss to capital?

A A net gain of $845,000.

Q That is capital they didn't have on October 31; is that correct?

A Correct.

Q Take a look at page 5, sir, is there anything on page 5 which relates tothe issue of a box count that has been discussed from time to time at this trial?

MR. BEEBE: Your Honor, why don't we just read from page 5?

MR. BROOKS: I could read it but I don't think anybody would understand it.

MR. BEEBE: I think we didn't get delivery on the earlier foundation and I don't know if we are just building foundations without houses. So I object.

THE COURT: Mr. Beebe is technically correct, Mr. Brooks.

MR. BROOKS: Maybe I should read it. If everybody thinks it's clear, I will move on. But I don't think it is.

THE COURT: Well, we have to work some kind of a compromise to make sense of this evidence.

Mr. Beebe, why don't we read it and if there is a need for an explanation, we will have it.

MR. BEEBE: I just found I had similar objections made on my presentation of the case. I don't mean to be overly technical. If there is some genuine foundation that this is not simply a way of bringing testimony that's already in and bringing it in again, I will withdraw my objection. But I think that's what's happening.

MR. BROOKS: I think Mr. Beebe's suggestion is a good one, your Honor. I will read it and then I will ask the witness some questions on the reading.

On page 5 it says:

"On January 2, 1969 we instituted a cyclical box count of securities to effect a complete count of all securities at least twice a year."

Q Now, Mr. Bishop, can you tell us what, in the practice of your trade, a cyclical box count is?

A Yes. There are two different ways of doing it. One is to take stocks in alphabetical order and do the A's one day and the B's another day, and so forth, and you get all of them done over a six-month period.

Another way is to do the same thing according to the date that the firm pays a dividend, because you want to make sure that everything is straight on the day a dividend is declared or paid so that the right customers get the dividend.

Now, if you do it that way, that leaves over some stocks that do not pay dividends, so you have to pick them up and do them at some time as well.

The difference between that and the other kind of box counting is when you do a non-cyclical box count, you count all the stocks on the same day.

Q Is a cyclical box count a positive step toward correcting record keeping problems?

MR. BEEBE: Objection, leading and asking for a characterization and it's conclusionary.

THE COURT: How do you get at that without coming pretty close to it in the first instance?

MR. BEEBE: I should think in a situation like this you ask him did he do it, which he did.

MR. BROOKS: Is it good orbad? Maybe it's bad.

MR. BEEBE: Certainly this man is not the man to testify. He will say everything is good. I think that's fair. That's really what is going to

happen.

MR. BROOKS: I object.

THE COURT: Yes. STrike that.

Ladies and gentlemen, disregard comments of counsel here.

The objection is overruled.

Q Do you have the question in mind, Mr. Bishop?

A Yes.

Q Tell us.

A The answer is that it's good because it gives one an opportunity to analyze whether there are errors in the stock record for a particular stock on a particular day and straighten them out. It also gives you these errors in manageable pieces. Maybe you will get 25 of them at a time instead of thousands.

Q On page 6 of the exhibit it says:

"In December 1968 McKinsey & Company, management consultants, were retained to assist us in improving the profitability and to increase the efficiency of operations."

Did you have any knowledge at that time of McKinsey & Company?

A Yes.

Q What did you know about them?

A I had interviewed them on several occasions with the possibility of doing work for the exchange. They were a leading firm of management consultants. Most of the auditing firms have divisions that do this kind of work. They are a great big organization of people who consult on different kinds of business problems.

Q I'd like to read three paragraphs on page 6.

"Mr. Owen W. Yager, CPA, became vice president in charge of operations in September 1968. Mr. Thomas Cassidy, formerly vice president and director of First Boston Corporation, became senior vice president-underwriting in October 1968."

Skipping a paragraph -- maybe I should not skip.

"Since that time, six additional officers, all experienced in corporate finance, have joined the firm. Mr. David W. Rome, CPA, formerly with Lybrand, Ross Brothers & Montgomery, became controller in November 1968."

Mr. Bishop, of the three gentlemen whose names I have read, Mr. Yager, Mr. Cassidy and Mr. Rome, do you know which of those were people who would function at McDonnell & Company in their back office or on

back office problems?

A I would think all three of them.

Q Mr. Bishop, let me show you Exhibit AA, which is the examiner's white sheet on the 1968 audit of McDonnell & Co. Do you recall having seen that at about the time of your meeting with McDonnell and Co. personnel in January of 1969?

A I don't recall whether I saw this document at that time or not or whether I had information extracted from it. But I knew of the situation reflected here.

slh 1 Bishop-direct

Q Do you recall a meeting that you had with McDonnell & Company and discussed the problems that they had?

A Yes.

Q Do you recall who was there?

A I think McChesney, McKay -- I don't really remember who else was there; perhaps Stock--

Q How about Mr. Schuette?

A He would have been there, yes.

Q Mr. McElroy?

A Yes, he was there. He had been looking at this.

Q Now, what did you tell the people from McDonnell & Company at that meeting?

A Yes, I remember this meeting a little better --

MR. BEEBE: Could we fix a date on this?

Q Could you fix a date, Mr. Bishop?

A I don't like to fix dates but I think it is the January 29th meeting.

Isn't that what we are talking about, the 28th?

Q Let me show you an exhibit which I have pre-marked Exhibit NNN --

MR. BEEBE: Before we do that, can we get the answer as to what he remembers without looking at exhibits as to that very important meeting? I don't think his recollection has been completely --

MR. BROOKS: I believe he said it was January 29th, he wasn't sure.

MR. BEEBE: Well, if it's just for that date I have no problem.

MR. BROOKS: Well, I am planning to offer this in evidence and discuss it at length, your Honor, and here is a good point to do it.

THE COURT: Does that help you with the date?

Q Take a look at the first paragraph --

MR. BEEBE: May we have a copy?

MR. BROOKS: Sure (handing).

BY MR. BROOKS:

Q Look at the second paragraph.

A Yes, this locates the date of this meeting as January 29th.

Q Does that refresh your recollection?

A Yes.

Q Let's focus on this letter of February 24th for a moment.

Do you recall having seen this letter on or about the 24th when I presume it arrived at the exchange.

A Yes.

Q Does this letter describe a response that McDonnell & Company made to discussions of the meeting of

the meeting on January 29th?

A Yes.

MR. BROOKS: I offer this in evidence.

MR. BEEBE: I guess my only objection is we had Mr. Spies here, and it was addressed to him, and we don't have him any more, so I would object that it seems to be doing it differently than I have been required to do.

MR. BROOKS: Your Honor, I don't see what the problem is. It happens to be addressed to Mr. Spies, and I think it is quite clear from all the testimony that Mr. Bishop was the man who made the decisions in these matters, and he has testified that he reviewed this when he came in.

THE COURT: There is no question that this is an authentic letter of McDonnell, is there?

MR. BROOKS: Your Honor, I note that it was marked as Plaintiffs' Deposition Exhibit 48 for identification on some date in 1973.

THE COURT: I am asking Mr. Beebe to respond, because he is the objector here. I am asking him if there is any objection as to its authenticity.

MR. BROOKS: I'm sorry.

MR. BEEBE: Well, I suppose I don't have any objection to its authenticity, and I guess I will preserve

whatever I may have as to how it is used with this witness.

THE COURT: Very good. It may be received.

(New York Exchange Exhibit NNN received in evidence.)

BY MR. BROOKS:

Q Mr. Bishop, let's now get back to the January 29th meeting.

Do you recall what you said at that meeting?

A Yes.

I believe that I had come to pretty firm conclusions before this particular meeting with my staff -- as to what McDonnell's financial condition was, as we interpreted it; so I told McDonnell that they had to improve their capital by getting into compliance, by improving their capital by about half a million dollars, the same half million dollars that I mentioned a few minutes ago, within a very short period of time, and then they had a somewhat longer period of time to get themselves a cushion, and I think that was it in the financial area.

Q What did the spokesman for McDonnell & Company say to you?

A I think they immediately said that they could and would do it.

Q Did you tell them how to improve their capital

position by the $500,000 or the additional amount to come in at a later date?

A No.

Q Does the stock exchange have any reason for caring how a firm improves its capital position?

A No.

Q Nothing in Rule 325 about how it improves it, is there?

A No.

Q Did McDonnell make good on their reply to you that they would bring in the $500,000 or so on the dates that you gave?

A In my first demand I think they almost doubled--they did better by almost a hundred per cent.

Q Did they do that in the time period you gave them?

A Yes, they did. I think in the second amount, I think they asked me for about a week's extension in getting that amount, which I think I gave them.

Q And did they then get that amount?

A Yes, they did.

Q Do you recall anything else about that January 29th meeting?

A I don't think I stayed at that meeting a long time. I think perhaps the meeting continued after I left with

the intention of their discussing improving their operations.

Q Let me show you, Mr. Bishop, a letter dated January 30, 1969, which has been marked as Exchange Exhibit CC in evidence.

It is addressed to you.

Do you recall receiving that on or about January 30, 1969?

A Yes, and I recognize Mr. McKay's signature on it.

Q If I may characterize the letter, it advises you that there has been a deposit to the existing subordinated account of Anna McDonnell and a deposit to the existing subordinated account of Marjorie F. McDonnell.

Was this, sir, the first time that you learned that there was to be or that such a deposit was in the wind?

A From these people, yes.

Q Did you learn that there were deposits for many people in the wind before you got this letter?

A No. I knew that they had promised to improve capital. I assumed that someone at least would come in with new capital.

Q The letter reads in the third paragraph:

"The securities combined have a capital value of approximately $950,000."

Was that the figure you were referring to before when you testified they almost doubled the requirement?

A Yes. They almost doubled their deficiency.

Q What, then, was their capital position after this deposit went into effect?

A They would have about, oh, $450,000 or $475,000 in excess in their capital.

THE COURT: Are you going on to something else now?

MR. BROOKS: Yes.

THE COURT: We will take our mid-afternoon recess.

(The jury left the courtroom.)

THE COURT: Mr. Beebe, let me ask you two questions which I neglected to ask before lunch:

Do you contend that the stock exchange intended to liquidate McDonnell & Company at the time that the subordinations were made either in January, February, 1969?

MR. BEEBE: Are you saying do I contend that they intended to liquidate --

THE COURT: Yes, was it their intention that the company be liquidated?

If your answer is yes then I am going to ask you what the proof is.

MR. BEEBE: That's why I am hesitating, your

Honor, because I don't see, in addition to the other contentions we have in the complaint, and so on, and the pre-trial memorandum whether there is a given point in time that we have established that the exchange embarked upon a liquidation plan. Maybe there should have been. I think it is a fair question. I just, as I stand here at this second, I cannot give you a minute by minute answer--

THE COURT: I take it you are not going to argue to the jury that the exchange let all of these people put money in knowing they were going to wind up the business?

MR. BEEBE: Well, the reason I hesitate is that we look at it slightly differently. We look at it from a point of view of, in effect, had all these people put money in and did not take all the other steps necessary at the same time, then they say they had this cushion that came up -- well, I don't want to argue too much detail because this is the testimony that is going to come out right now, and the witness is standing right here --

THE COURT: Why don't you go to that door, Mr. Bishop.

(Witness left the courtroom.)

MR. BEEBE: I apologize, Mr. Bishop, but really--

MR. BROOKS: Your Honor, I think we should exclude Mr. Beebe's client.

MR. BEEBE: That is perfectly okay.

THE COURT: Mrs. Murphy, you may step out.

MR. BROOKS: I would just as soon they both stayed.

MR. BEEBE: The situation is, I have a little trouble with these arguments-- I am still trying to prove--

THE COURT: I am trying to get some focus on what it is that is the liability claim here, and the factors that are involved are so numerous and so interdependent that they cause an enormous amount of difficulty in seeing things clearly at times.

MR. BEEBE: I think you are absolutely right.

THE COURT: I am trying to get some things out of this case if I can.

If you were going to say that the stock exchange knew in January, 1969, that McDonnell was going to be closed out and permitted new money to come into it, that's one thing. But I don't think you are arguing that. Exhibit 86 seems to permit you that kind of an argument, and I sort of had a feeling this morning that you are making that kind of an argument.

MR. BEEBE: If you are focusing on 86, let me not make that argument at this point.

THE COURT: But I want to find out. I want to get

a definitive answer to my question if you want to give it to me. If you don't want to give it to me that is one thing.

MR. BEEBE: No, I don't want to shy away from the question. I think that what 86 points out particularly is that it was the rules back at that point, the rules that they were not enforcing, that they were not enforcing against McDonnell & Company. Now whether they --

THE COURT: But that is something different. You can pass the question of whether they enforced the rules well or ill. Apparently, according to 86, you could argue that there came a time that the exchange had decided that McDonnell was going to have to be liquidated and it should be gotten down to a workable liquidation size. But the question is, did that state of mind come into existence before the plaintiffs in this case put in the money that is in issue.

MR. BEEBE: I think the only straight answer I can give you is that I haven't proved that yet and I am going to try and argue every favorable inference to the jury.

THE COURT: At this point there is no proof of that?

MR. BEEBE: Well, I really don't think I have gotten substantial in to lead to that proof yet.

THE COURT: Well, if you find something between now and the end of the proof you let me know, will you?

MR. BEEBE: Yes. That's fair enough.

THE COURT: Okay.

MR. BEEBE: But if I don't -- you know and it is in there, I don't want it held against me.

(Recess.)

(In the courtroom in the absence of the jury.)

MR. BROOKS: Is the witness permitted to be here?

MR. BEEBE: Oh, I think for this, it is going to be very short, it is all right.

THE COURT: Go ahead.

MR. BEEBE: Sir, I have given further reflection to your question just before the recess, and it seems to me that another inference that we are seeking to draw, and a good deal of proof has come in on this, is that when the money dried up and the exchange could no longer reach out, or McDonnell & Company could no longer reach out and pull money in, the plan became one to pare it down and slowly put it out of existence in the manner as it occurred.

Now, if that plan was in the back of the mind or part of the exchange's plan in January, in other words, if they couldn't have raised from our clients in January, they would have started it right away. In fact, there was

already what has been called a black Friday plan that was extant at that point, and I think from the existence of the trust fund and a number of other things that have come in evidence the jury might infer that indeed this was part of the plan, and I can't -- I don't want to take that away. I don't want to take away the right to argue that to the jury. I don't want to give it away; I don't want to waive it.

THE COURT: Unless you have some proof of that besides what happened, unless you have some memo, some conversations --

MR. BEEBE: I don't think it is the kind of thing that people write down.

THE COURT: I know, but you cannot go to this jury on a scheme to get money in from investors knowing that they are going to close the company up --

MR. BEEBE: As an alternative I think --

THE COURT: -- unless you have something to go on.

MR. BEEBE: As I say, I think I have principally, sir, the Exhibit 85 and the trust fund and the testimony of Mr. Arning and the testimony of Paul McDonald and the testimony of the --

THE COURT: That is all certainly no earlier than May or June, probably June, because Murray is putting money

in in May.

MR. BEEBE: I think all the pieces were in place long before then, sir, because if our people had not come in -- I think the company and the exchange really had no choice --

THE COURT: Well, Mr. Beebe, absent some piece of proof that would permit a finding by a fair preponderance of the evidence I would not let the jury speculate on whether or not a scheme existed to put McDonnell out of business in early January of 1969 irrespective of whether your clients put money in.

MR. BEEBE: I think that's what I am saying, that if they didn't put money in -- the second part --

THE COURT: He had the right to close them up; if they didn't meet the capital requirements he could have put them out of business, that's clear; but the question is, to let them put the money in and put them out of business anyway, and I don't think there is any proof of that that the jury could conclude that, certainly January, February, 1969.

MR. BEEBE: I have no law at this point. I may have later.

MR. BROOKS: While we are considering this, your Honor, I think under the standard of Radiation Dynamics or

a 50(a) motion or any other case, the cases all say that speculation, surmise and conjecture are not enough to meet the burden --

THE COURT: I understand.

(The jury entered the courtroom.)

BY MR. BROOKS:

Q Mr. Bishop, will you take a look at Exhibit NNN which is before you, the February 24, 1969, letter to Department of Member Firms.

Does that letter contain any further restrictions that McDonnell & Company imposes upon itself at this time?

A Yes, on page 4.

Q Are you referring to points 1 through 9 which continue over to page 5, si

A Yes.

Q May I read those:

"1. We have cancelled plans for new branch offices, excepting a Chicago office approved in 1968, opening in March, 1969.

2. We have cancelled proposed sales training classes for 1969.

3. We have sharply reduced firm positions and trading accounts.

4. We have sharply curtailed our advertising

budgets.

5. We are transferring and shipping out small inactive cash accounts.

6. We have refused over-the-counter buy orders of less than $1,500 principal amount.

7. On January 2, 1969, we instituted a cyclical box count of securities, to effect a complete count of all securities twice a year, while continuing to count securities for dividend purposes, and government bonds weekly.

8. We are close to conversion to our new securities processing system, as described above, which will furnish us with the tools to keep current on our work, and to eliminate remaining backlogs.

9. We have increased minimum equity requirements for new margin accounts to $4,000 from $2,000."

Mr. Bishop, how does increasing the minimum equity requirements for a margin account help back office problems?

A It would reduce the number of customers who would have the wherewithal to have a margin account and therefore reduce the number of margin accounts, and customers could not buy as many securities because they would not have credit available.

Q It is a method of cutting down business?

A Yes.

Q Mr. Bishop, at this time did the exchange give any consideration to liquidating or suspending McDonnell & Company?

A No.

Q Will you tell me why it did not give such consideration?

A We didn't have any grounds for doing so. McDonnell was in capital compliance; they had a program for cleaning up their past errors as shown by the audit, and they had under way a new program, a computer program I am talking about, which would give them capacity to handle the kind of business they had. They were a going firm.

Q What was their financial condition, sir?

A Let's see. I believe by this time they had excess net capital of over $2,000,000 --

MR. EEEBE: I believe this is just reading from the exhibit.

THE WITNESS: No. I am refreshing my memory to see whether at this date the money had come in. You are asking me questions about February 24th.

Q Do you recall what their net worth was about the time of the audit report?

A It was in the neighborhood of fourteen or

sixteen million dollars.

Q What was the best information you had on the profits, past profitability, the profit record up to date?

A The last reports we had had on profitability were that they were profitable. We didn't have up to date information, I think, in that area.

MR. BEEBE: Can we pinpoint what the last reports were, what the dates of the last reports were?

Q Can you tell me the dates on the last report?

A We had had the 1967 income and expense reports complete, and I believe we had something that showed the first eight months of 1968.

Q Mr. Bishop, is there any rule of the stock exchange which would have permitted you to close down McDonnell & Company on this set of facts?

MR. BEEBE: Objection. That calls for a legal conclusion, and the rules are in evidence.

THE COURT: I know, but he is the man who is charged with determining the applicability of these.

MR. BEEBE: I believe one of the issues joined here, your Honor, is whether or not he should have, and the exchange should have, applied the rules to take complete delivery action than was taken.

To ask for a conclusionary statement along these lines I find not only irrelevant but prejudicial and conclusionary. It is also asking for a legal interpretation.

MR. BROOKS: This man is the interpreter of this body --

THE COURT: Yes. I will overrule you and I may cross-examine as you see fit.

Q Do you have the question in mind?

A Yes. If I would have taken the action of suspending McDonnell at this time I deserve to be fired and probably would have been.

THE COURT: Strike the answer.

The answer is no, as I gather it.

MR. BEEBE: Thank you, your Honor.

THE COURT: You're welcome.

Q Mr. Bishop, is there anything about the proposed transactions that we are brought here to discuss, the subordination of Margaret Murphy and the increased -- the deposit to Anna McDonnell's subordinated account that you know of that would arouse the exchange's suspicion that any wrong would be worked on these two ladies in the course of these transactions?

A No.

MR. BEEBE: I object to that question, sir, as to form, as to calling for a conclusionary answer. I find this line of questioning of very doubtful relevance to the jury.

THE COURT: From looking at the complaint I -- overrule the objection.

Q Mr. Bishop, do you have before you the January 30th letter that advised you that Anna McDonnell -- let me do it a little better, your Honor, and maybe it will save Mr. Beebe.

Let me show you, Mr. Bishop, what I believe the documents were that you received in connection with Mrs. Murphy's subordinated loan. I first show you New York Stock Exchange Exhibit A, which is a letter to the secretary

of the exchange signed by Morgan F. McDonnell, member of the exchange, submitting Mrs. Murphy's application, which is New York Stock Exchange Exhibit 1. I believe you also got her subordination agreement and related attached documents, which is Plaintiffs' Exhibit 3.

My question is, sir, is there anything about those documents or any other knowledge you have about the transaction which would excite any suspicion on the part of the exchange or your department under its normal practices?

MR. BEEBE: Same objection.

THE COURT: That's pretty broad in form, Mr. Brooks.

Q Is there anything about that transaction which would arouse your suspicion that there was any wrong being worked on Margaret Mary McDonnell Murphy?

MR. BEEBE: Not even substantially worded. I have the same objection. I think the facts speak for themselves, is really what I am getting down to.

MR. BROOKS: I think this is substantially the question your Honor permitted, with the exception that I have shown the witness the documents to try to make it more concrete.

THE COURT: Overruled.

A The answer is no.

Q I show you Exhibit CC, which is a January 30th letter to yourself from Thomas A. McKay advising you that Anna M. McDonnell and Marjorie F. McDonnell had increased the amounts of their subordinated accounts. Is there anything in that letter or what you knew aside from that letter to arouse any suspicion that Mrs. Anna M. McDonnell was not being dealt with fairly by McDonnell & Company?

A No.

Q Mr. Bishop, as soon as Miss Solomon gets it out I am going to show you the allied membership application of James McDonnell, Jr. to the exchange to permit him to become a voting member of the stock of McDonnell & Company. I ask you to review it and ask you if there is anything in that document with respect to his transaction which would arouse any suspicion on the part of the New York Stock Exchange that James F. McDonnell, Jr. was not being dealt with fairly by McDonnell & Company?

MR. BEEBE: Same objection. It is going to the ultimate fact. It is not, I believe, a proper way to examine a witness. We are talking about facts.

THE COURT: Mr. Beebe, I don't know that he is going to an ultimate fact except to the fact of what this man's state of mind was. Was he aware of any impropriety

in connection with James coming in. That's what the question is.

MR. BEEBE: I believe that's an ultimate fact, sir. That's my objection. Not his state of mind. I don't think that's relevant. I object to the ultimate fact. Those facts are proved by the facts in the case and not a quasi-legal question like this.

THE COURT: Come to the side bar.

(At the side bar.)

THE COURT: Now, the ultimate fact, and I am still not sure you are right as a matter of law on this because I am having this still researched and it is under consideration. But your ultimate fact is whether or not there was a duty on the stock exchange to see to it that the McDonnell management told these people the same things that they had told the stock exchange. That's the ultimate fact. This seems to me not an ultimate fact as to whether or not this man had any reason to beliebe that a fraud had been committed on anybody by a McDonnell officer, which I think is quite a bit different. If I am wrong in that, correct me.

MR. BROOKS: I think this is evidentiary and goes to the propriety of the conduct of the exchange. If there was something in this transaction which showed that perhaps a subordinated lender was getting no interest at

all or was being over-reached upon, perhaps the exchange might have a duty. But I think the duty has to be measured on the facts of the case.

MR. BEEBE: Let me just give one thought on this. To me the ultimate fact is whether there was a wrongdoing and I would analogize it to a car in an automobile negligence case. It is like asking the driver were you negligent or asking someone else was the driver negligent? That is the ultimate fact to be proved one way or another. So you ask did he apply the brakes, did he swerve, questions of that nature which go to the facts.

THE COURT: I am still not sure you are entitled to this as a matter of law but one of your contentions of wrongdoing is that the exchange had a duty to make sure these people knew the condition of the company.

MR. BEEBE: Knew the material adverse facts.

THE COURT: That's one of their contentions. That's a different thing than asking this man whether at the time these papers came to him he was aware of material misrepresentations or omissions being made in connection with there being obtained. That is all.

MR. BEEBE: I find it the same but also the word inthe question, as I remember it, is "wrongdoing."

THE COURT: I don't think he used that word.

MR. BEEBE: The question goes to that effect, I believe.

MR. BROOKS: Is he being dealt with fairly.

THE COURT: That's the word he used.

MR. BEEBE: That's what touched me off because I thought that was one of the ultimate issues, whether each of our clients was being dealt with fairly.

MR. BROOKS: I use that as a shorthand way of saying were they receiving proper disclosure and not getting false and misleading information.

THE COURT: I suppose the other way around, Mr. Brooks, is whether or not he was aware of any impropiety in connection with this money being raised.

MR. BROOKS: I thought if I asked that question en-gross I would try to give him the documents to show what the exchange got. Mr. Baebe can get up and say what about paragraph 10 here, Mr. Bishop?

MR. BEEBE: I do that on cross.

THE COURT: I think it is appropriate for this record to determine whether this man believed there was anything improper in the way the money was raised. I take it that's all these questions are addressed to.

MR. BEEBE: I guess I don't think that's in itself what his personal belief is. It is shifting the issue away

from what really happened. If a man is driving negligently but he thinks he is driving properly, it is irrelevant.

THE COURT: There is something wrong with your analogy and I can't quite put my finger on it.

MR. BEEBE: Malfeasance is very akin to negligence.

MR. BROOKS: Part of the argument on the fraud case is knowledge, which is sometimes called scienter. To aid and abet, or to be a controlling person requires you to know of the fraud that's being committed by somebody else. Nobody said the exchange committed the fraud and I am going to the point of whether we know or the stock exchange knows of any fraud being committed.

THE COURT: Mr. Beebe, your paragraph 14C charges that the stock exchange aided and abetted McDonnell in unlawful conduct in approving the subordination and knew or should have known that it had been procured by fraud. It seems to me you have a right to ask -- this is what I was referring to earlier.

MR. BEEBE: No problem with that. I think if it were a question along the lines of did these documents which you received from the McDonnells make you know or suspect on their face that a fraud was being committed.

MR. BROOKS: That's pretty much what I asked.

THE COURT: That's pretty much what he asked.

MR. BEEBE: In that phrase I don't think I would have any problem with that.

THE COURT: Let's leave it in for the purpose which is what it was being asked for.

MR. BROOKS: I don't want to use my phrase.

MR. BEEBE: I think mine is better than his.

MR. BROOKS: Then you ask it yourself.

THE COURT: You may cross-examine on that.

(In open court.)

MR. BROOKS: Do we have an open question and if we do can you find it?

(Question read.)

A I have reviewed it and the answer is no.

Q Mr. Bishop, let's move on. Let me show you Exchange Exhibit GG in evidence and Exchange Exhibit HH. I think I am not characterizing these documents unfairly by saying that they reflect a request for a work plan by Mr. Stock and a reply by Murray McDonnell saying we will get one right up.

There was some testimony that a Mr. Schuette at this time had suggested that restrictions be imposed and that this option was elected instead.

My question to you, sir, is did you take part in the decision making that centered around the election

to go the work plan route rather than the restriction route in about April, 1959?

A Yes.

Q Can you tell me what the considerations were at that time which led to adopting the work plan route rather than the restriction route?

A As I recall it, the firm was already under self-imposed restrictions so that we wouldn't be accomplishing much in a practical sense by imposing the same things as restrictions.

On the contrary, we thought what was necessary was to get the firm more completely and logically organized to correct its problems, and that was called a work plan, having them organize themselves to the point where they could set down in writing exactly what they were doing, the searchers they had to do it, and so forth, the outside people they had hired, so that we could evaluate, on the basis of our experience with other firms, whether this work plan had a reasonable chance of overcoming their problems in concurrence with the restrictions they had already imposed on themselves.

Q Was this technique of requesting a written work plan from a firm that was having back office problems a familiar one at the exchange at this time?

MR. BEEBE: Objection. Are we getting into what happened at the other--

THE COURT: Yes, the objection is overruled.

A Yes, it was. The words "work plan" were sort of new words at the time with our staff to describe this technique, but we had been using it since 1968 or even earlier when there weren't as many occasions for it.

Q Was there any reason why Mr. Stock particularly was assigned to this phase of the operation of the work plan project?

A Of course he was an expert in this field because a major part of his work at the midwest stock exchange had been straightening out this kind of thing for firms that got mixed up during their conversion to the midwest stock exchange system.

Q Could you give us a little more background on exactly what Mr. Stock did at the midwest stock exchange that made him particularly appropriate for this assignment?

A Well, the biggest problem we had had prior to the paper work problem had been at the firm of Thompson & McKinnon which in 1966 had massive problems arising from their conversion to the midwest system.

It got to the point where Mr. Cunningham, who was then the head of the midwest service system, but

later became executive vice president of the exchange and was at this time, Mr. Cunningham personally went into Thomson & McKinnon with Fred Stock as his assistant to supervise the straightening out of their problems. And I'd say that's where Fred Stock became an expert in this field.

Later on, in 1967 and early 1968 Fred Stock did the same thing in several other firms, and in fact when I hired him in thelatter part of 1968 he was down in Atlanta straightening out Robinson Humphrey. So he was a real expert in this field.

Q Mr. Bishop, I don't think you told the jury what the Midwest Stock Exchange System is.

A Okay. The Midwest Stock Exchange had, and still has --

Q Let's skip for a minute again. The Midwest Stock Exchange, is that a national securities exchange like the New York Stock Exchange?

A Yes, it is. Smaller and it's located in Chicago. They have a subsidiary that runs a big computerized bookkeeping system which is designed to be used by multiple member firms.

Now, what happens, when a trade is made the member firm punches out the details of the trade, or

any other transaction, and some punched tape and that data is transmitted by wire to Chicago where it's processed. At that time the Midwest computers in Chicago print it out, all of the statements and all of the kinds of bookkeeping records for that particular firm and send them by special transportation arrangements to the firm, wherever it was located.

Now, they have about 50 or 60 firms that they kept the records for, of which Thomson & McKinnon was probably the largest and Robinson Humphrey would be one of the medium sized ones.

I guess by that time they also had a computer center in New York where they did the same type of thing for the firms in this area.

Q Was it there that Mr. Stock achieved some experience with computer conversions?

A Yes. He was a head of the whole conversion and systems and record straightening out team of the Midwest Stock Exchange for the country. He worked out from Chicago.

Q Now, let's look at the other side of the coin, sir. Would there have been any disadvantages to what you were seeking to obtain if you had imposed restrictions on McDonnell & Company?

A I suppose it depends on what extent they delivered from McDonnell's own restrictions. I suppose it could have had an effect on their sales and consequently reduced their income more, which would make their profitability more difficult.

Q What effect do restrictions have on employees, stock exchange restrictions?

A Well, again, that depends on the extent to which it is necessary for theemployees to know about the restrictions. But there were times when all the brokerage firms that were seeking employees. There weren't enough knowledgeable ones to go around and they were bidding each other up on salaries. So that if the employees of a firm got the idea that their jobs had any impermanence about them, they would want to go to another firm right away rather than waiting.

So there would be the possibility of employees leaving.

Q Let me show you stock exchange Exhibit TT, which has been previously identified as the plan submitted in response to Mr. Stock's request. Did you see that at the time, sir, or have any knowledge of its coming?

A Yes, I did.

Q Is that plan similar to plans that have been worked out or that have been worked out for other member firms prior to April of 1969?

A In appearance of course it's different because everybody, you know, made up their own presentation. But in substance it's similar in that it had sort of similar approaches to the same types of problems that other firms had.

Q Had other firms solved similar problems in the past with work plans of substantially the same nature?

A Yes, they had.

Q Can you tell us the names of some of those firms, sir?

A Lehman Brothers, I believe, for example, was at this time about finished with cleaning up their records on a similar plan. Thomson & McKinnon, of course, had accomplished it three years earlier. Hayden Stone was along the road.

I don't recall other specific firms by name. I'm sure there were others.

THE COURT: Mr. Brooks, are you going on to something else?

MR. BROOKS: Yes, your Honor.

THE COURT: Ladies and gentlemen, I have to recess court now. I will see you at 10 in the morning.

We are going to sit tomorrow, and depending on whether we complete the case tomorrow, which is a possibility, we will hear arguments of counsel on Monday and I will charge you Tuesday morning.

(Adjourned to May 15, 1975, at 10 a.m.)

MARGARET MARY McDONNELL MURPHY, et al.
v.
McDONNELL & CO., INC., et al.

May 15, 1975,
10 A.M.

--

(In the courtroom in the presence of the jury.)

R O B E R T M. B I S H O P, resumed.

DIRECT EXAMINATION CONTINUED

BY MR. BROOKS:

Q Mr. Bishop, I am going to put before you Exchange Exhibits EE and EE-1. These are some exchanges. One is an internal memorandum and the other is a letter from McDonnell & Company to the exchange talking about the subject of the rejection of a million dollars or so in capital contribution from a trust, the trustees of which were Manufacturers Hanover Trust and Marjorie F. McDonnell.

Do you have any knowledge of that event?

A Yes, I remember being personally involved.

Q Can you tell me what the circumstances were?

A Mrs. Murray McDonnell was the daughter of a man named Flanagan I think, who had some bank, I believe, and there was consequently a trust called the Flanagan Trust which proposed to make a loan to McDonnell for

capital purposes of something in the neighborhood of a million dollars.

In accordance with our usual practice we sent the trust instrument over to Milbank, our lawyers, to find out whether that trust was authorized to make such capital contribution. And Milbank's trust lawyers said they didn't think it was authorized and we should not approve it.

I thought that was rather odd because the trustee of the trust was the Manufacturers Hanover Trust Company, and the lawyers for the Manufacturers Hanover I think were Shearman & Sterling and maybe some other lawyers -- perhaps I am wrong on that -- but, anyway, their lawyers, who were some very good Wall Street firm had given their opinion that the trust could make the loan.

So I sent it back to Milbank again saying, "How could you possibly say this when this other law firm is saying the opposite and when the Manufacturers Hanover, who certainly knows their business in being a trustee, is on the opposite side.

Well, Milbank's trust lawyers held their ground and I consequently decided that we would not approve the Flanagan Trust as a lender.

Q Did McDonnell obtain additional capital to make

up for the rejection of the Flanagan Trust?

A Yes. I believe Murray McDonnell borrowed personally a million dollars from the First National City Bank, which he contributed, and a little later he borrowed six hundred and some odd thousand dollars more from the same source.

Q When that kind of an event occurs, does the exchange require that the documentation on such a borrowing be submitted to the exchange for approval?

A Yes, we did.

Q Let me show you what I pre-marked as Exchange Exhibit PPP and ask you if you can identify that.

A Yes. This is the letter which Mr. McKay, whose signature I recognize, sent to the exchange on May 5th, and he must have sent it by hand because our date stamp indicates we got it on the same day, and attached to it is a copy of the note by which Mr. Murray McDonnell, whose signature appears on it and I recognize, borrowed the money from the First National City Bank.

Q Is this a personal loan by Mr. McDonnell?

A Yes, it is.

Q What then happens to the funds that he borrowed?

A He then takes those funds and puts them into one of his own subordinated accounts at McDonnell, so that

the purpose of our getting this is to make sure that the obligation for this borrowing runs to Mr. McDonnell personally and not to the firm of McDonnell & Company.

Q Why do you want to know that, sir?

A Well, otherwise it would need to be subordinated in the usual kinds of forms that we have in these other cases here.

Q You mean in the claim of the National City Bank, the lender?

A Yes. We don't want the bank to have any claim against the firm because they have not been approved as a lender to a member firm. It is Mr. McDonald who has been approved.

MR. BROOKS: Your Honor, I offer Exhibit PPP in evidence.

MR. BEEBE: No objection.

THE COURT: It will be received.

(New York Exchange Exhibit PPP received in evidence.)

BY MR. BROOKS:

Q Mr. Bishop, I now show you a parallel set of documents dated May 19, 1969, pre-marked as Exchange Exhibit QQQ, and I ask you if those documents are essentially the same as the last exhibit but for the $650,000 loan of T. Murray McDonnell on or about May 19th?

A Yes, they are, but there is an additional document here which I think maybe has just been lost from the previous one, which is a letter from the First National City Bank setting forth briefly that they understand and agree that it is a loan to Mr. McDonnell and not to McDonnell & Company.

Q Did I understand you to say that it would have been customary to obtain such a letter in connection with the first lending?

A Yes.

Q Would the letter have been the same?

A Yes.

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MR. BROOKS: I offer QQQ.

MR. BEEBE: No objection.

THE COURT: It will be received.

(New York Exchange Exhibit QQQ received in evidence.)

BY MR. BROOKS:

Q Mr. Bishop, at this time -- I guess we are up to May 19, 1969 -- McDonnell was still on self-imposed restrictions, is that not right?

A Yes.

Q At about this time did you have occasion to communicate with the SEC about firms that were under

restrictions?

A I did it constantly.

Q Let me show you what I have pre-marked as Exchange Exhibit 000, which appears to be a copy of a letter by yourself to a Mr. Stanley Sporkin of the SEC, and I ask if you can identify that.

A Yes, this is a copy of a letter that I sent to Mr. Sporkin.

MR. BROOKS: I offer it in evidence.

MR. BEEBE: I assume this was produced previously?

MR. BROOKS: No, sir. This was not produced. This letter was found only recently when we undertook a search pursuant to a subpoena of Mr. Beebe's to locate some additional documents for production at the trial. It was not known to exist at the time of our discovery production and it was not in the files of McDonnell & Company at the exchange. It was in a separate file relating to communication with the SEC.

MR. BEEBE: What was the date when it was discovered?

MR. BROOKS: I don't know.

MR. BEEBE: In terms of a week or two ago? My subpoena was, I believe, almost a month ago. Why don't I have it before today?

THE COURT: Well, in any event, what position do you take with regard to it?

MR. BEEBE: I'd like to know -- I would object to its being admitted because we specifically had a notice to produce, which has obviously failed to produce relevant documents like this one and this was discovered recently and not turned over, as it was obviously known

it was going to be used for examination. On top of that I would like to know what other surprises are going to be forthcoming.

THE COURT: Let's stick with this one letter.

MR. BEEBE: In the case of this one document I object to it being introduced since it should have been produced earlier under the rederal rules as we requested document production. I specifically supplemented that by a specific request, that if anything came up in terms of last-minute trial preparation, it was my understanding there was an agreement it would be turned over to us as soon as it was discovered. This clearly was not.

THE COURT: Mr. Bishop could testify to these facts, could he not, whether or not you have the letter?

MR. BROOKS: I believe he could, your Honor.

THE COURT: Do you claim that you would need time to deal with this letter?

I'll tell you what I'm going to do: I will permit the letter to go in evidence. If you feel additional time is needed on your case to deal with it, I will grant it to you.

MR. BEEBE: Very well, sir.

One question on the letter. It references an enclosure. I assume the enclosure is among the missing or is it around, too?

THE COURT: I would assume that's the list.

MR. BROOKS: Yes. The list was not with the letter when it was found and we could not find the list. Since McDonnell & Company's name from the letter clearly does not appear on the list, I'm not sure that it's relevant in any event.

(Defendant Stock Exchange Exhibit OOO was received in evidence)

MR. BROOKS: May I read the letter and the PS?

THE COURT: You may.

(Defendant Stock Exchange Exhibit OOO in evidence was read to the jury)

BY MR. BROOKS:

Q Mr. Bishop, subsequent to this letter, which is May 25, 1969 --

MR. BEEBE: April, I believe.

Q I'm sorry, April 25, 1969, were restrictions placed upon McDonnell & Comapny?

A Yes.

Q What occasioned the exchange to place restrictions on the firm which we have seen a month earlier it decided not to place?

MR. BEEBE: I object. I don't think this is what the letter shows.

THE COURT: Amend the form of your question, please.

Q What occasioned the exchange to place restrictions on McDonnell & Co.?

A Well, as we went into May we became more and more dissatisfied with the progress of the firm, and as we realized more what our examiner had been finding there and also I think Mr. McKay had then gone into the hospital with terminal cancer and a satisfactory replacement hadn't come up yet, so that we were just getting more and more itchy about the firm and decided they needed a harder spur.

Q Let me show you what has been marked in evidence as Plaintiffs' Exhibit 56A. It's a letter dated May 21, 1969, to McDonnell. I believe it's signed by yourself, sir.

Is that the evidence of your restricting the firm of McDonnell & Company at this time?

A Yes.

Q Does the letter contain the restrictions which are placed upon the firm?

A Yes, it does.

Q I notice that after you have recited certain restrictions on their advertising, and so forth, in the middle of the first page there, you carved out from a restriction underwriting operations by McKonnell & Company. Can you explain why you did that?

A Well, I believe that we had discussed with McDonnell prior to writing this letter that we were seriously considering placing restrictions on them and that we were considering restricting them from participating in any underwritings. And I believe the head of their underwriting department had come over to see me and talked with me about the importance of their underwritings to their income. They did quite a bit in underwritings. You ordinarily make more profit on underwritings than you do on other types of security trades.

So that after that exchange with him I modified my position about it and I didnot restrict them from underwritings. Instead I placed a limit on their total trades of 12,000 per week, which was about 10 per cent under what they were currently doing. And I

made that figure include the number of underwriting items. So that I cut down on the number of total trades they could do without specifically saying you couldn't do underwritings.

Q Maybe we ought to pause for a moment and explain what an underwriting is. Would you do that,sir?

A An underwriting is a securities firm's participation in the distribution of a new issue of a security for a company, like American Telephone, if that's the one we were talking about yesterday. When a company wants to issue some new stock and they want a securities broker to help them do it, help distribute it among customers there are basically two ways of doing it. Either the member firm can buy the whole issue from the company and sell it at a slightly higher price to customers or they can contract with the company that they will make a sales effort to sell the number of securities the company wants to sell but that they will not be contractually bound to sell them.

They will just use their best efforts to sell the securities, and that's where those kind of efforts are called best efforts underwritings.

Q When the member firm sells these securities to the public does it have to make any disclosure to the

public about the terms of the security that it's selling in the underwriting?

A Yes, it does.

Q How does it normally do that?

A There is a document called a prospectus which explains the company's affairs in detail.

Q Does the exchange chaparone the preparation of those prospectuses and the issuance of the disclosure to the public underwritings occur in a member firm?

MR. BEEBE: Excuse me, I hesitate to get up and interrupt but I just don't see what in the world underwritings have to do with what we are doing here.

THE COURT: I seewhat underwritings have to do with it but I am not quite sure what supervision of the preparation of a prospectus has to do with it.

MR. BROOKS: I am trying to draw an analogy between this kind of operation that a member firm does and other operations involving disclosure and the disclosure involved in this case, and upon whom the exchange relies to make all this disclosure that member firms are requiredto make

THE COURT: I will sustain the objection.

Mr. Bishop, when a firm is restricted to

12,000 transactions a week, how do they cut it off? Does somebody at some point blow a whistle that's heard throughout the office on a Thursday afternoon or a Friday morning or whatever? How does it work?

THE WITNESS: That was a difficult practical problem which we left to the firm to see how it would be done. We used this on, you know, maybe 25 firms or so and they did it by variuos methods. They had to report to us what their trades were. And if they slipped over for one week we might forgive them, but they had to stay below it in general. If they slipped over by 100 or 200, we would understand it.

THE COURT: I take it if a customer called in and the transfer that week would be exceeded by his trade, the brokerage firm would say we can't take this, we will send you to somebody else?

THE WITNESS: If it was a sale of a customer who had securities at their house, they couldn't really do that. Instead they had to do things like reducing their number of registered representatives, not entering into things that they could control, for example, underwritings or a secondary offering. They just had to keep their business small enough to stay under that amount. For McDonnell this probably meant

they had to cut down a little more. It was 10 per cent under their previous trades.

THE COURT: All right.

Q I show you an allied membership application. I happened to pick Plaintiffs' Exhibit 1, which is Mrs. Murphy's, but I just show it to you for the sake of the form.

When an allied member enters into such an application with the exchange and is accepted by the exchange, is he making an agreement with the exchange?

MR. BEEBE: Objection. I think the document speaks for itself. That's a legal conclusion. Where does this lead?

THE COURT: Is this to go on to something?

MR. BROOKS: Yes.

THECOURT: Founded upon that statement?

MR. BROOKS: Yes.

THE COURT: All right, then I'll overrule the objection.

Q And does the agreement include his abidance by constitution and rules of the exchange?

A Yes.

Q Does that include thatprovision in the constitution which you told us has been there since the

beginning, in general abidance by fair and equitable principles of trade?

A Yes.

Q Now, are you familiar with Rule 342 of the stock exchange, sir?

A Yes.

Q I believe that's in evidence as part of Exhibit 32 or 34.

Can you tell me what -- I don't want you to recite the rule but just tell me what the thrust of the rule 342 is.

A The thrust of Rule 342 is to require a system of supervision within the member firm. It says that the owners of the business must name a person or group of persons to be in charge of the firm and control it, and that that person delineated -- that's the chief executive -- and that that person must in turn delegate responsibilities for various facets of the firm's business to other competent people and that he must assign them responsibility and that he must have a separate system of followup and review to make sure that they are performing that responsibility.

So that we put the responsibility on the chief executive and the people that he delegates.

Q Would a fair but somewhat crude analogy be the captain of the boat?

A Yes.

Q Is he the person that the exchange looks to to maintain the proper running of the firm in accordance with the rules?

A Yes.

Q And does the proper running of a firm include a proper disclosure to investors required under the various securities laws when they purchase securities?

A Yes, it would.

Q Would that include that very same disclosure to people who are capital contributors of the member firm?

A Yes.

Q Who was the person at McDonnell & Co. who had been designated under Rule 342 as the capital ofthe vessel?

A Murray McDonnell.

Q Are you familiar with the rules and practice that were in effect in mid-1969 on the question of whether income tax refunds could be considered as good capital by a member firm?

A Yes.

Q Can you tell me what the rule and practice was on that question?

MR. BEEBE: Excuse me, could we break that into parts, first the rule and then the practice?

THE WITNESS: I'll cover them both.

THE COURT: Take both of them.

Q The rule, if any, sir, and then practice, if any.

A There wasn't any rule. There was some section of the capital rule which generally dealt with assets that were readily collectible under how this type of thing would be treated would be an interpretation.

Now, the practice was that ordinarily if a firm filed an application with the government for an income tax refund or if they hadn't even filed it yet but just throught they were entitled to it because they had been losing money, they wouldn't get any capital credit for that.

However, when it reached the stage of certainty about the government paying it, then we would give capital credit.

The most frequent way by which that happened was that there comes a time -- we are dealinghere with

a special kind of tax refund called a quick key refund for corporations in which the government, as I understood it from numerous lawyers, didn't have much option about whether or not they would pay the refund, but they did have to process it. Then if there was any argument about it they argued later.

There came a time in the government's processing where they finished looking at the papers and sent it to their checkwriting department to have a check written.

At that point they would send a letter to the firm saying that we have finished processing your papers and we sent it to the checkwriting department to have a check written.

So firms could routinely start counting the refund as good capital at that point because usually the checks took about ten days to get there.

Now, some firms who didn't want to wait that long would take special measures to give the exchange an assurance that their refund was properly filed and could be expected within a reasonable period of time. Sometimes they would have their own lawyers take the papers up to Andover, Massachusetts where they were processed and walk them through the staff of

the Internal Revenue Service up there.

If the lawyers came back and told us that it had reached the stage where they were the government was definitely going to pay it within a short period of time we would give them capital credit.

Othertimes a firm and their lawyers would tell us that they believed everything was in order but they hadn't really gone up there in person and walked it through, and in some of those cases we had our own lawyers, Milbank's tax people, call up people that they knew at Andover and ask them if ti was true that such and such a firm's application was there and there didn't seem to be any problem with it coming through.

So there were maybe 20 or 50 cases in the two-year period we are talking about wherethat was done.

THE COURT: 15 or 20 did you say?

THE WITNESS: I think I said 20 or 50.

THE COURT: These cover all of the special measures?

THE WITNESS: Yes. I meant where either their lawyers -- I was excluding the instances where the ten-day letters were received.

THE COURT: I see.

BY MR. BROOKS:

Q Are you familiar with a member firm circular that stated a practice or an interpretation of the exchange that if you could show proof you were going to get an incometax refund within 30 days you would be entitled to claim capital credit for it?

A I think there was one but I don't clearly remember it.

Q Did you have any knowledge about the negotiations of McDonnell & Company to sell their advisory company which provided advisory service to the McDonnell Company mutual fund in about December of 1969?

A Yes.

Q Can you tell me what you know about that transaction?

A Well, I remember that it went on twice, I think once in the summer and once later, but, in any event,

Scheinman, Hochstein & Trotta, which was another member firm that had a business relationship with McDonnell in the rights business, and which they were also interested in acquiring, they wanted to do something to help McDonnell out in its problems during the summer of 1969, and they also, of course, wanted to improve their own lot by acquiring some of the good properties that McDonnell had, and one of them was this company, the subsidiary of McDonnell that managed a mutual fund.

So Scheinman, Hochstein & Trotta negotiated with McDonnell to buy thatfund, and eventually they did buy it.

I am not sure that they did in December.

Q Did these negotiations result in any impact on McDonnell & Company's condition under the New York Stock Exchange capital rule?

A It could have. I don't remember whether it did or not, but it could have because the mutual fund management company appeared in McDonnell's financial statement as stock in the subsidiary, and we did not give any value to that because it was not readily marketable; it couldn't be readily sold. It could be sold privately but not readily.

Consequently, there was the possibility that if

it was actually sold money would come in for it, and then the money would be capital for our rules purposes.

Q Well, did you afford capital credit to the proceeds before they came in?

A I don't think we did.

Q Can you recall exactly what the situation was in respect to the proceeds from the sale of the mutual fund management company and the application of your Rule 325?

A I think there was a sort of a different arrangement that was worked out which had promise of giving immediate capital credit, but I am not sure whether it was ever actually implemented.

But this arrangement was that Scheinman agreed to buy the mutual fund management company, and McDonnell agreed to sell it, but they were contingent upon getting the necessary approvals done. I think they had to have a meeting of the board of directors and do different kinds of things, so it couldn't be done immediately.

So Scheinman agreed that in the meantime if needed they would make a subordinated loan directly to McDonnell & Company of 600-odd thousand dollars. And it is that loan that we would have looked at for capital rather than the transaction of the mutual fund.

Q Let me show you a letter dated July 24, 1969,

addressed to the exchange, to your attention, and ask you if that reflects the agreement of Scheinman, Hochstein to make a subordinated loan and to buy the mutual fund management company, and, on the other hand, the agreement of the McDonnell Company to sell the mutual fund management company?

A Yes, it does. The subordination is in paragraph 4.

MR. BEEBE: I would object to the characterization. I think it is a letter of intent. I don't think there is an agreement in there at all.

THE COURT: The letter will speak for itself.

Is there any objection to its admissibility in evidence?

MR. BEEBE: No, not by me.

THE COURT: All right, Exhibit RRR may be received in evidence.

(New York Stock Exchange Exhibit RRR received in evidence.)

BY MR. BROOKS:

Q Is it your testimony that any capital credit that would have been given before the consummation of the transaction would have been credit for the subordination that is described in this letter?

A Well, I certainly would have given it if the

subordinated loan had been made, but I might also have given it just based on this letter.

Q Why do you say that, sir?

A Because we had what to my mind is an irrevocable commitment by another member firm.

Now, a member firm is different, in our view, than anyone else. They are under our regulation. They are subject to our constant review; we are well acquainted with them. I couldn't conceive of a member firm backing out of this kind of a written commitment to the exchange.

Q Were you present when Exhibit RRR was signed?

A Yes.

Q Did Mr. Scheinman sign on behalf of Scheinman, Hochstein & Trotta? Was he that person, if you know, who was designated under Rule 342 to be the captain of the ship at Scheinman, Hochstein & Trotta?

A Yes, he was.

Q I notice it appears to be Harry Lindh who signed on the signature line for McDonnell & Company.

A That's correct.

Q Then there seems to be another signature below that.

Do you recognize that signature?

A Yes, that is Morgan McDonnell.

Q How did it come that you had two people sign for McDonnell & Company?

A Well, Mr. Lindh was relatively new at the firm, and I thought we ought to have a signature of the McDonnell family, and Murray wasn't around -- rather than the McDonnell family I should say I thought we ought to have an officer of the firm who was also a member of the McDonnell family and a principal executive so I would be sure we had a proper signature.

Q Mr. Bishop, are you familiar with the term "SEC oversight inspection"?

A Yes.

Q What does that mean?

A The SEC from time to time sends in teams of their personnel to look at a particular part of my regulatory activities to see how we are doing, in other words, whether we are doing our job.

Q Do you recall an SEC oversight inspection of your activities in respect to the firm of McDonnell & Company having taken place in the summer of 1969?

A I believe there were some.

Q Let me show you a letter I pre-marked as Exchange Exhibit SSS signed on behalf of Kevin Thomas Duffy, Regional Administrator of the SEC's New York office by his

chief attorney, Michael L. LeBlanc, addressed to Mr. P. Fitzgerald of the stock exchange; and then I will show you at the same time a reply letter the same day by Mr. Fitzgerald to -- I am not sure -- it appears to be an employee, Mark Epstein of the SEC's regional office in New York, and I ask you if you can identify these two letters.

A Yes, except the name of the chief attorney for the SEC was Blane, I think.

Q Do these letters evidence the SEC oversight inspection of the exchange's files in respect to McDonnell & Company which you have testified about?

MR. BEEBE: I object to the word "evidance."

Q Does it show?

MR. BEEBE: Well, they show what they show.

THE COURT: Yes, sustained.

MR. BEEBE: Are these being offered in evidence?

MR. BROOKS: After a few more questions they will be.

BY MR. BROOKS:

Q Were you advised of an event such as the SEC oversight inspection in your files?

A Yes.

Q Were you advised of this oversight inspection?

A Yes.

Q Did you authorize Mr. Fitzgerald to make available the files that were requested?

A Yes.

Q Do you recognize Mr. Fitzgerald's initials on the top left of these two letters?

A Yes, both of them, and also, of course, the one that he signed over his signature.

Q I call your attention to the SCQ letters. Are those letters familiar to you, sir?

A Yes. That is for the special operations questionnaire file, and Mr. Fitzgerald's initials are directly under that in both of them.

MR. BROOKS: I offer these two documents in evidence.

MR. BEEBE: I wasn't concerned about the genuineness. My question and objection is whether these were among the documents that turned up recently.

MR. BROOKS: No, these documents were among the documents made available to Mr. Beebe's firm in 1971 where we produced all McDonnell's files.

MR. BEEBE: Then I have another question about the document -- I don't know if you gave it a number but it's the one apparently signed by Mr. Fitzgerald or initialed by him - "Enclosed please find documents."

I suggest it would be appropriate to have the

enclosures too.

MR. BROOKS: The enclosures were not with the letter, your Honor. The enclosures would appear to me to be copying that was done from the exchange's files. They are not identified exactly what documents were requested in either of the letters, but the entire files have been made available.

THE COURT: Yes. That does not present a problem at this point.

MR. BEEBE: Well, my problem, sir, is that they are addressed to Mr. Fitzgerald by Mr. Fitzgerald, and the only connection with this gentleman on the stand appears to be that he was another person involved in that department at the time, perhaps in another capacity than Mr. Fitzgerald. It would be helpful to have Mr. Fitzgerald and especially the enclosures here.

So I would object to having them introduced.

MR. BROOKS: Your Honor, may I comment on that?

In our discovery before this trial started on the question of who wanted who to be available as a witness, Mr. Beebe considered Mr. Fitzgerald and told me that he did not want Mr. Fitzgerald around as a witness. Consequently I told Mr. Fitzgerald he could undertake a two-week cruise in this period.

I think Mr. Beebe has waived his opportunity to have Mr. Fitzgerald.

MR. BEEBE: I don't think that is exactly fair since I didn't know Mr. Fitzgerald was going to be brought in through letters at this point.

THE COURT: But, Mr. Beebe, are you questioning the fact that this letter was sent and the other was received?

MR. BEEBE: I question the relevance and I question examining this witness about it, yes, sir.

MR. BROOKS: I have no further questions on these letters, your Honor. I just think they should be in evidence.

THE COURT: You don't question their authenticity?

MR. BEEBE: No.

THE COURT: All right, they may be received.

MR. BEEBE: I would like to establish some mechanism to make an attempt to find the enclosures so that when I cross I can examine about those enclosures.

THE COURT: I would gather at this point that the enclosures are with the Securities and Exchange Commission, if located.

MR. BROOKS: And the originals would be in the exchange files, all of which were made available to Mr. Beebe in this same SCQ file.

MR. BEEBE: That is precisely what I am getting at,

sir. The enclosure, a letter from Mr. Fitzgerald to Mr. Epstein, would be in the SOQ file which they have. We made an arrangement with them when I subpoenaed all the files --

THE COURT: Mr. Beebe, come up.

(At the side bar.)

THE COURT: Mr. Beebe, why do you want the enclosures? What would you do if you had these enclosures?

MR. BEEBE: Did we get on the record they were passing their wand over this?

THE COURT: Having gotten that magic in the record, as far as the rule is concerned, these letters are in to show that the SEC was involved in this situation in a certain way.

MR. BROOKS: That's all.

THE COURT: What is it that you would want the enclosures for?

MR. BEEBE: I would like to see precisely what the exchange sent to the SEC. We did have an arrangement that each of us would keep the files available for the other rather than have them subpoenaed --

MR. BROOKS: That is true.

MR. BEEBE: I would like the enclosures.

MR. BROOKS: There are none.

MR. BEEBE: If there are none there --

MR. BROOKS: There are no segregated enclosures.

MR. BEEBE: My argument is, what is the probative value of SSS without the enclosures?

MR. BROOKS: It shows simply the SEC's oversight of the stock exchange files.

THE COURT: I take it this permits an argument to be made to the jury that what the exchange was doing was reasonable, and that it was being supervised.

MR. BEEBE: And somehow approved.

THE COURT: I don't know that you can say approved.

MR. BROOKS: I haven't said that yet.

THE COURT: But at least was being supervised to some degree.

MR. BEEBE: I guess, your Honor, I really make a request for the enclosures so I can know. But if they don't have them, they don't have them.

MR. BROOKS: I don't have them.

THE COURT: What happens in late August or early September with regard to these enclosures that is going to affect your case? Do you contend if this document was sent or wasn't sent that is going to make a change in the outcome of the picture?

MR. BEEBE: I don't know what we are going in for.

If it is going to affect the outcome or influence the jury's opinion, it may very well affect my case.

MR. BROOKS: I think the matter can't go any further than the fact that I can't produce the enclosures. I don't know what they were. There was no list.

MR. BEEBE: Then I can't go further than that.

(End of side bar discussion.)

(In open court.)

THE COURT: Received.

(New York Stock Exchange Exhibit SSS and TTT received in evidence.)

MR. BEEBE: I think, your Honor, SSS was the one from Mr. Blane to Mr.Fitzgerald. And TTT was from Mr. Fitzgerald to Mr. Epstein.

BY MR. BROOKS:

Q Mr. Bishop, did there come a time when Lybrand Ross returned to the premises of McDonnell & Company in the year 1969 to undertake its surprise audit for that year?

A Yes.

Q Did they commence the audit?

A Yes.

Q Did they seek an extension for that audit?

A Yes, they did.

Q Did they, as they did in 1968, supply a letter similar to their December 23rd letter in 1968 to support that request for an extension?

A Yes, we were still using the same four questions.

Q Let me show you what I have pre-marked as Exchange Exhibit UUU and ask you if that is a letter that was supplied in respect to the extension requested as to the 1969 Lybrand audit of McDonnell?

MR. BEEBE: I am having a little trouble reading the second page.

Do you have a better copy?

MR. BROOKS: No.

A This was that letter that was supplied to the exchange as well as McDonnell & Company to whom it is addresssed, and it did come to my attention, yes.

MR. BROOKS: The December 23, 1968, letter, which was similar to this one, your Honor, is Exchange Exhibit DD in evidence.

BY MR. BROOKS:

Q Mr. Bishop, does this letter differ in substantial message from DD, which was the letter of the prior audit?

A Yes.

MR. BEEBE: Your Honor, first could I have the witness give me a chance to get up and object?

THE COURT: Yes. Let's strike that answer out, and I will sustain an objection to the form of the question.

Q Mr. Bishop, you testified yesterday that DD gave you certain assurances on which you felt it possible to grant the extension?

A That's correct.

Q Of the 1968 audit. How about UUU, did that provide such assurance to you?

A No.

Q Tell me where it lacked the assurance that you needed to grant the extension. Tell me in what respects it lacked the assurance that you needed.

A Well, I believe it says that they have considerable doubt, although they hadn't finished their audit, they had considerable doubt that McDonnell was in capital compliance at the date of the audit or at the time they wrote us this letter on February 2.

That's the most worrisome thing about it. They also say they are going to report on material inadequacies in record keeping.

Q Did you grant an extension for this audit report, sir?

A I believe not.

MR. BROOKS: I offer Exhibit UUU in evidence.

MR. BEEBE: No objection.

(Defendant Stock Exchange Exhibit UUU was received in evidence)

Q Mr. Bishop, what did youdo about the report contained in Exhibit UUU that Lybrand couldn't tell you that the firm was in capital compliance at the audit date, couldn't tell you they were in capital compliance as of the date of that letter which is February 2, 1970?

A Well, of course, first by not granting an extension we were demanding that the audit be completed.

Second, I assigned a new team of staff members to look at McDonnell's situation as it then existed and what the audit was finding, and this team was headed by Dave Fuchs, who had been the head of my income and expense section, which was the section that got the annual reports on profitability.

This staff was experienced in consulting with firms on elements of profitability, where firms were weaker than other firms, in making cost analyses of member firms.

So I assigned him to head a team that also included, I think, some members of the coordinator's staff, to analyze and try and project into the near term future what the possibilities were for McDonnell and how much success each one of them projected for it.

Q Did they render such a report?

A Yes, they did.

Q Did they have a bottom line recommendation in their report, sir?

A I think they came ot the conclusion that unless McDonnell was able to come up with some alternative--I think they had three ideas that they examined, and they rejected two of them unless McDonnell was able to come up with specifics that would, in a very short period oftime, show that they were wrong.

Their conclusion was that the only reasonable alternative left for McDonnell was to deliver out the rest of their customer accounts and liquidate, go out of the securities business.

Q I show you Exchange Exhibit VVV, which is addressed to Fred Stock and yourself, dated March 11, 1970, signed by David Fuchs and Paul Fitzgerald, and I ask you if that is the report which you have testified about just now.

A This is it.

MR. BROOKS: I have retyped the first page, your Honor. The original is below it because I thought there was a legibility problem.

I now offer VVV in evidence.

MR. BEEBE: V as in Victory?

THE CLERK: Yes.

(Pause)

MR. BEEBE: I was looking for the exhibits. Are they attached or available?

MR. BROOKS: They are not attached, your Honor, and they weren't attached when Mr. Beebe's associate, Mr. Dubin, marked this as Plaintiffs' Exhibit 120 at the deposition. I don't know where they are today and if they wanted them they have had a couple of years to get them.

MR. BEEBE: I don't know that that is a valid answer. I don't have any objection to VVV.

(Defendant Stock Exchange Exhibit VVV was received in evidence)

Q Mr. Bishop, from the time you received Exhibit UUU, which is Lybrand's letter of February 2, 1970 -- do you have a copy of that?

A Yes.

Q (Continuing) Onward, during the rest of the existence of McDonnell & Co. as a member firm, did you understand McDonnell & Company to be in violation of the exchange capital rule?

MR. BEEBE: May I have that question back?

THE COURT: You may.

(Question read)

A I accepted it as a probability, not as a certainty.

Q Did you permit them to continue in business for a period of time thereafter that uncertainty developed?

A Yes.

Q What was going on in McDonnell & Company during the period that you permitted them to continue in business while being uncertain whether they were in compliance with the capital rule?

A Well, of course, the delivery out of the customer accounts from the closed offices continued. And otherwise McDonnell was by then a very small firm. It had only a limited number of customers still being serviced by the few producers who stayed with them. Plus the rights business, and the rights business was being carried on.

Q What were they doing with the customer accounts in that period which you permitted them to continue?

A They were continuing the process that had been going on all the previous fall and winter of delivering

them out to the brokers or the customers, as instructed by the customers.

Q Who was running the firm at this time, sir?

A Paul McDonald and Harry Lindh, and Murry was still there too, but I guess you would say all three of them were.

Q Do you know the date when McDonnell & Company finally closed its doors?

A March 13, 1970.

Q Were you in the courtroom yesterday when Paul McDonald testified about a meeting he had with Chairman Budge of the SEC about six weeks before McDonnell & Company closed its doors?

A Yes.

Q Did you have any communication with the SEC about February 2, 1970, in respect to McDonnell & Company?

MR. BEEBE: Objection, relevance.

THE COURT: Overruled.

A I'm sure that we did. I can't specifically remember it.

Q Mr. Bishop, I now show you a copy of Plaintiff's Exhibit 86, which, as you recall, is a letter by bulletin signed by Robert W. Haack, president of the

New YOrk Stock Exchange, to members and allied members. It's dated October 1970. It's a two-page bulletin, and attached to it is a memorandum of about seven or eight pages.(handing). Take a look at that, sir.

Did you have any role in preparing Exhibit 86, sir?

A Yes. I wrote the long section of it, page 3 on.

Q Who wrote the first two pages?

A Someone summarized what I had said in the long section into the first two pages which I then reviewed and made sure that they said what I thought I was saying in the longer section.

THE COURT: This section is the one entitled "An exchange report."

THE WITNESS: Yes.

THE COURT: You say you are the author of that section?

THE WITNESS: Yes. Others helped edit and review it but I was the original writer.

Q Take a look at the top of page 2, sir, of Mr. Haack's bulletin where it reads, "A question often asked is why did the exchange allow a few member firms to continue in business despite critical paperwork and

capital problems."

Thereafter it goes on to identify McDonnell & Company as one of the firms that that sentence is speaking about.

Can you tell me when McDonnell & Co. had critical paperwork and capital problems?

A In this context I deemed them to be at about the same time that I placed restrictions on them in late May of 1969.

Q Is that the same date for both paperwork and capital?

A Well, more capital than paperwork, but I guess paperwork too.

Q When did you first detect a reluctance or inability of McDonnell & Company to add to its capital as needed?

A Well, the inability came along about the same time and later. They continued to be willing --

Q But not able?

A Not able, right.

Q Do you recall a meeting with James McDonnell sometime around Memorial Day 1969?

A Yes.

Q Would that meeting and the subsequent weeks

be the time in which the new capital well at McDonnell & Company ran dry?

A As far as the family is concerned it seemed to. There were attempts that seemed promising later in the year from other people.

Q Take a look, if you would, sir, at the bottom of the third page of the memorandum portion of Exhibit 86, and I will read that, if I may.

"For example, in the case of three major member organizations, the exchange found itself facing situations where normal application of rules could have meant possible loss for many thousands of customers and potential chaos in the industry."

The next sentence goes on to identify McDonnell & Co. as one of those firms.

Sir, can you tell me the first time in which the exchange did not apply in a normal manner its rules to McDonnell & Co.?

A I believe that was in February of 1970, after we received this Lybrand report.

Q Up until the liquidation, I suppose, in March?

A Yes.

Q Let me read a sentence in the next paragraph

to you, sir. It says, "The hope was a scaled down firm would present a manageable liquidation situation."

When was the first time that the exchange gave consideration to a liquidation of McDonnell & Co.?

A I think it was in this same period when my staffwas doing this special analysis. By "same" I mean February and March of 1970.

Q When you say an analysis being done by your staff, are you referring to Exhibit VVV, Mr. Fuchs' and Mr. Fitzgerald's memorandum?

A Yes.

Q After McDonnell & Company went into liquidation did hteexchange bring any disciplinary proceedings of any kind?

A Yes, we did.

Q Let me show you Pliantiffs' Exhibit 83, which is a memorandum addressed to the board of governors from the department of member firms, referring to, it would appear to be, certain charges brought against McDonnell & Co., Incorporated and T. Murray McDonnell.

Does Exhibit 83 reflect institution of disciplinary proceedings, sir?

A Yes.

Q Can you describe the process which Exhibit 83 is a part of in the disciplinary function of the exchange?

A It's parallel to something I think I explained yesterday in that we first draw up a memorandum which the staff believes to express the facts that we think are the bases for the disciplinary charges that we are about to make. Then we specifically state in charges, which are paragraphs saying exactly what we are charging the person with, in this charge memorandum.

Then we serve that on the people that we are complining about and they have a period of time, which I think was 20 days at that time, subject to extensions which we may give if their lawyers don't have time to get it done or something of that nature, in which they can furnish a written statement of their position in this matter, whether they agree or don't agree and why, and so forth.

Then the staff considers whether we still want to maintain the charges after we see what they have to say. And if we do, then we have two alternatives, and we have told them about these two alternatives in our first submission to them of this

charge statement. Either we can see if they want to make an offer of settlement, to accept the penalty and guilt without going through a hearing; or if they don't want to do that, then they can go through a hearing, which is before an appropriate committee or the board of directors of the exchange, in which they appear, the staff of the exchange who is making the complaint appears, and anybody who is going to be a witness appears, and the parties have occasion to question each other and the witness and, of course, the committee can.

Then the committee comes to a decision. Now, if the board of directors had assigned responsibility for people like McDonnell and Murray McDonnell to its advisory committee to hear these hearings, if the staff was only seeking a fine, a censure, or, I believe, a suspension. If we were seeking an expulsion it had to be heard by the full board.

Even if the hearing was before the advisory committee the board had to approve either the penalty arrived at after a hearing or the offer of settlement which would be recommended by the committee.

Q I take it the charge memorandum charges violations of the exchange rules; is that a correct assumption?

A That's correct, or of the constitution.

Q How about SEC rules, does it charge violation of applicable SEC rules?

A There is a section of the exchange constitution that provides for disciplinary action bythe exchange in the event of violation of exchange rules, yes.

Q Weee there any violations that you determined to have been committed by McDonnell & Company put into those charges which became Exhibit 83 known to the exchange before the exchange received word of the Lybrand audit in January of 1969?

A I think only one.

Q What was that, sir?

MR. BEEBE: I believe the Lybrand letter which you may be referring to, UUU, is dated February 2, 1970.

MR. BROOKS: I am referring to the Lybrna audit as of October 31, 1968, which was received by the exchange in mid-January '69. I believe my question to Mr. Bishop was, were any of the violations in the charge memorandum known to the exchange before it received that audit in January of '69.

THE WITNESS: Just the one, which was

McDonnell's failure to have their auditors file their 1967 audit in the prescribed time.

Q Why were charges brought against T. Murray McDonnell?

MR. BEEBE: Objection to the form of the question, a why question addressed to a party witness. I'm not objecting to the line of inquiry. I just think the form is wrong and perhaps irrelevant unless there is something that this is moving to.

MR. BROOKS: I don't know how else to get at the matter, your Honor.

MR. BEEBE: I think there are a lot of ways. I always found ways.

THE COURT: Maybe you will tell Mr. Brooks a couple of ways.

MR. BEEBE: If I knew where he was going I'd be happy to.

THE COURT: Mr. Beebe, isn't the door somewhat opened by your Exhibit 83 as to explain the reason for the --

MR. BEEBE: Why charges were brought against McDonnell & Company?

THE COURT: No, T. Murray McDonnell.

MR. BEEBE: Perhaps if he just went into

what the charges were, that would be a fair line of inquiry, if I could make that suggestion.

MR. BROOKS: That doesn't help me get where I want to go.

MR. BEEBE: I object to the question as posed.

THE COURT: Go on to something else, Mr. Brooks, for a minute.

Q Mr. Bishop, was T. Murray McDonnell being charged in his personal capacity or in his representative capacity?

A Well, he was being charged because he was the head of McDonnell & Company, but, of course, he was also being charged as a person, but they were all for failure to perform his duties as head of McDonnell & Company. They were not for personal deficiencies such as dishonesty or lying to the exchange or things of that kind. They were all supervisory type charges.

Q Would it be fair to say that the charges were that he didn't run a tight ship at McDonnell & Company?

A That would be a mild expression of it, yes.

Q The charges are dated October 1970, sir. The last page is a consent to penalty signed by yourself

and T. Murray McDonnell.

Was the consent to penalty signed at about the same time as the charge memorandum was dated October 1970?

A No, I think it was quite a bit later.

Q Do you recall when?

A January or February of 1971.

Q What accounted for the delay?

A Well, initially Mr. McDonnell didn't want to make an offer of settlement. He was very incensed that we had brought charges against him and very emotional about it. I wasn't willing to face the fact that he was --

THE COURT: Strike that last little bit out. Go ahead.

Q What penalty did you offer to T. Murray McDonnell?

A A suspension and his being barred for life from being an allied member or supervisory person in an exchange member firm.

Q If you are going to bar him for life, what did the suspension relate to?

A Well, that meant that he could continue being a registered representative after the suspension period was up.

Q You wanted to suspend him from being a registered representative?

A We wanted to suspend him for being anything in a member firm for a period of time. Then we would let him come back as a registered representative or supervised employee.

Q Not as the head of a firm or officer in charge?

A Right. He couldn't be in charge of any departments either.

Q Did Murray McDonnell have a known reputation in the member firm community as a producer, sir?

A Yes. He was a very big one.

Q And if he is suspended as a registered representative could he be a producer?

MR. BEEBE: Objection. I just don't see how this fits in. I mean there may be some facts here but where they slot into the issues in this case I don't know. So I think it's irrelevant.

MR. BROOKS: It's part of the document Mr. Beeb e put in evidence because the consent to penalty refers to this matter Mr. Bishop is talking about.

THE COURT: Yes, I think on this state of the record I will overrule the objection.

Q You have mentioned some acrimony --

A I don't think I answered that question. I have forgotten what it was.

Q Do you recall it?

A No.

MR. BROOKS: Read it back.

THE COURT: -- We will take a recess and have the reporter locate the question when we come back.

(Recess)

MR. BROOKS: Mr. Reporter, would you read the pending question?

(Question read.)

A No. He would lose his income for that period.

BY MR. BROOKS:

Q Mr. Bishop, in the course of these discussions with Murray McDonnell about the penalty that you urged that would suspend him as a registered representative, did he make a written presentation as he was entitled to in response to the charge in the memorandum?

A Yes, he did.

Q Let me show you Exchange Exhibit WWW which I have pre-marked for identification, and ask you if that is the written presentation.

A Yes, this is.

Q It is addressed to you, sir. Did you receive it?

A Yes.

Q I note this is not a signed copy.

Did you receive a signed copy of it?

A I believe I did.

Q Is this a true copy of a signed copy, just not signed?

A I believe it is.

MR. BROOKS: I offer this in evidence, your Honor,

as Exchange Exhibit WWW.

MR. BEEBE: No objection.

THE COURT: Received.

(New York Stock Exchange Exhibit WWW for identification received in evidence.)

BY MR. BROOKS:

Q Mr. Bishop, when you got this did any of the language in it appear familiar to you?

MR. BEEBE: Objection.

THE COURT: Yes, sustained.

Q Mr. Bishop, do you recognize in this letter any of the phrases that you had drafted which became part of Exhibit 86?

MR. BEEBE: Objection.

If this is in the way of argument that this question is being put in this way, I don't think i is proper.

THE COURT: Yes, that question troubles me.

I will sustain the objection.

BY MR. BROOKS:

Q Does Exhibit WWW, Mr. Bishop, to your knowledge adopt any language that was in Exhibit 86?

MR. BEEBE: Objection. Same objection.

THE COURT: That can be determined by a reading

of the two exhibits.

Q Mr. Bishop, take a look at the bottom of page 1 of Exhibit WWW where it says:

"I negotiated in good faith after a full investigation by the SEC and agreed to this settlement under which the Commission permitted me to at least earn a living for myself, wife and nine children as a stockbroker. To consent to any suspension in addition appears to me to be unduly harsh and inequitable in view of all the circumstances."

To what was Mr. McDonnell referring to there, if you know, sir?

A He had entered into a settlement with the SEC back in 1969, in April, I think, under which he had agreed-- let's see, I guess that is the right year -- in which he had agreed to -- no, I guess it's the wrong year, maybe it's 1970 -- at any rate, the settlement agreed that he would be barred from supervision but it did not suspend him.

Q And you wanted to suspend him as a registered representative?

A That's correct.

Q After you got Exhibit WWW, sir, did you have any meetings with Mr. McDonnell in which you responded to the letter?

A Yes.

Q Tell me what you said to him.

A I told him that this reply would never stand up before the board; that he was just parroting back things that had been in our circular.

He seemed to me to be lashing out emotionally--

MR. BEEBE: I will object to this.

THE COURT: Why are we getting into this?

MR. BEEBE: I will object to this.

MR. BROOKS: I think the question was entirely proper. I asked Mr. Bishop what he said to Mr. McDonnell when he had a meeting with him after receiving WWW, and that is what he is telling us, what he said to Mr. McDonnell in that meeting.

THE COURT: But I am curious as to why that is relevant to any issue that we have before us.

MR. BEEBE: On top of the plain hearsay problem.

MR. BROOKS: How could it be hearsay if Mr. Bishop said it?

THE COURT: That is not the problem.

MR. BROOKS: I think the letter --

THE COURT: You are now going into the litigation of the Murray McDonnell suspension hearing and what were the positions the adversaries took prior to a ruling.

MR. BROOKS: If Mr. Beebe will agree not to refer to the letter I will agree not to try to put it in context.

MR. BEEBE: Your Honor, with all due respect, that's ridiculous. I don't see how that kind of statement can be made. The question is, how does the question that is pending to the witness move the case along in any respect? The letter is in evidence.

MR. BROOKS: The question is what response Mr. Bishop made to T. Murray McDonnell in a meeting he had with T. Murray McDonnell after he received this letter.

MR. BEEBE: And I object.

THE COURT: And this is some time after November, 1970?

MR. BROOKS: Yes.

THE COURT: How does anything Mr. Bishop said to Murray McDonnell at that point become relevant to the issues here?

MR. BROOKS: Well, we are still within the disciplinary process which Mr. Beebe has put before the court when he put the charge memorandum and the attached consent in evidence.

I am trying to show how we got from the charge memorandum to the attached consent, what the negotiations were, and what was said to whom, by whom, and why we have

the consent which we do, which is part of Exhibit 83.

THE COURT: Well, it seems to me the only purpose of the charge memo is for the statement of facts in it. If I am wrong about that, Mr. Beebe, correct me, but that is what I see as the only purpose of this offer, a statement of the fact purporting to be an admission against interest of the stock exchange.

MR. BROOKS: But apart from that, the last page is consent to penalty.

THE COURT: The consent to penalty is excludable, and would have been excludable if there had been an objection to it.

MR. BROOKS: But I think it relevant, your Honor, because part of their claim against the exchange is that it did not enforce its rules and did not discipline its members, to wit McDonnell & Co. Incorporated and T. Murray McDonnell among others this, up until the signing of the consent decree constitutes that disciplinary process which we are accused of not having done.

THE COURT: What Mr. Bishop and Murray McDonnell may have traded by way of words in a meeting some time in November, 1970, I don't see to be relevant.

MR. BROOKS: If it plays a role in arriving at the consent to penalty, I think it is.

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MR. BEEBE: I think it is getting so far afield, your Honor--

THE COURT: I will sustain the objection.

BY MR. BROOKS: Mr. Bishop

Q Mr. Bishop, after your meeting with T. Murray McDonnell did he agree to a suspension as a registered representative?

A After some time elapsed, yes.

Q And is that reflected in the consent to penalty which is part of Exhibit 83, the last page?

A Yes, it is.

Q Was that penalty a greater penalty than imposed by the SEC on Mr. McDonnell?

A Yes.

Q Greater to what extent?

A To the extent of his suspension from any activity, including that of registered representative, and, I believe, the bar from supervisory and allied member activities was somewhat broader. I don't recall that too well.

Q Whose was broader?

A Ours.

Q It can't be any more broad than for life, can it?

A No.

Q Now let's back up a number of months to March 13, 1970, and the liquidation of McDonnell & Company.

Will you explain how that process works? What exactly was done to bring about what we call the liquidation of McDonnell & Company?

A McDonnell & Company and the exchange and the special trust fund entered into a contract whereby if it became necessary for the trust fund to furnish moneys to help out McDonnell's customers, that the event of furnishing such moneys would trigger the exchange's right to appoint a person to be in control of the company, and that person, who is called a liquidator, would have all the functions that the chief executive and the board of directors of a company normally has under other circumstances, and the trust fund would make moneys available to that person who in this case happened to be Mr. Pat Scorese.

He had been the second person in charge of operations at Bache & Company. His job was -- he retained most of the employees of McDonnell who were engaged in delivering customers' accounts, including Mr. Lindh who was his principal assistant --

MR. BEEBE: Excuse me, could I object again in the sense that this seems to be wandering a good deal. It

is interesting, but it is a question of relevance. Could it be focused just a little?

MR. BROOKS: I asked him to explain what the process was of the liquidation because we just talked about liquidation of McDonnell & Company, and nobody really knows what that is.

A (Continued) At any rate, he proceeded with winding down the affairs of McDonnell, or trying to collect amounts that they were owed; paying out the customers what they were entitled to, and where he didn't have enough McDonnell assets to do that he drew on funds that were made available to him by the special trust fund to purchase securities for customers or pay customers cash.

Q You mentioned a special trust fund. About a week ago we had testimony from Mr. Arning during which we introduced Exhibit III, which was the deed of trust of the trust fund which he identified as such.

Mr. Bishop, I notice that the deed of trust is dated 1964.

Were you on the scene at the exchange at the time this trust fund was created?

A Yes. I was not only on the scene but intimately involved.

Q Could you tell me what circumstances gave rise

to the creation of the deed of trust and thereby the trust fund?

A A member firm named Ira Haupt & Company had failed in the previous year, 1963. $37,000,000 were missing because of fraud by a customer, and the banks who were creditors and the stock exchange together decided to make up a plan to make the customers of the firm whole, to which the stock exchange had contributed about $9,000,000.

Then we appointed a couple of committees to see what we should learn as a result of that experience, and one of these committees recommended that we should provide for such matters in the future, make available the possibility of helping other firms if something similar should happen.

So this trust fund was the result.

Q When you say the banks and the exchange made the customers of Ira Haupt whole, do you mean paid them back their money or securities?

A Yes.

Q What kind of legal entity is this trust fund?

MR. HEEBE: The instrument speaks for itself I believe, your Honor. And that also definitely calls for a legal conclusion in the very basic question. So I object.

MR. BROOKS: I don't think --

THE COURT: Let's see what the witness says. It may be of assistance to the jury. The instrument may not be as revealing in that regard as his testimony, and it may be helpful.

Answer the question.

A It is a charitable trust organized under the laws of the State of New York.

MR. BEEBE: I don't find that very helpful your Honor. I find that very self-serving, and I would move to have that stricken.

THE COURT: Strike the answer.

Does the instrument cite under what provisions of the New York State law the trust is created?

MR. BROOKS: No, it does not, your Honor.

THE COURT: Does this witness have any basis for competent knowledge under the laws under which this was created?

MR. BROOKS: I believe he does.

THE COURT: Do you want to explore that, and if you can lay a foundation for it you may ask the question.

BY MR. BROOKS:

Q Mr. Bishop, are you familiar with the laws under which the trust is established?

A Not the laws.

Q Are you familiar with the state under which the trust has its existence as a legal entity?

A I understand it to be New York.

Q And what kind of a trust under the law of New York do you understand it to be?

THE COURT: This is the layman's definition of it, Mr. Brooks.

MR. BEEBE: I object.

THE COURT: I will sustain the objection.

Q Mr. Bishop, who are the beneficiaries of the trust?

A They are whatever customers of member firms might be in need of assistance that the trustees of the trust determine in their sole discretion to assist in the future.

Q Can the trustees assist other than customers of a member firm?

A No.

Q Can trustees assist subordinated lenders to a member firm?

A No.

Q Can they assist voting stockholders of a member firm?

A No.

Q Do you recall how much the trust gave in the way

of assistance to the customers of McDonnell & Company?

A I don't recall the exact figure but it was in the southern 29 million dollar range that has been talked about previously.

Q Had the existence of the special trust fund played any role whatsoever in the regulatory decisions that the exchange made in respect to McDonnell & Company prior to March 13, 1970?

A Yes. Since that February 2 to 5, 1970, period when the Lybrand audit came in that I talked about, when we didn't give the normal application of our rules thereafter, but prior to that date, no.

Q After February 5th in what way did the existence of the trust fund influence the exchange's application of its rules in respect to McDonnell & Company?

A Well, it then appeared very unlikely that McDonnell could come back into capital compliance, and we permitted them to continue doing what they were doing for those few remaining weeks while a liquidation plan was found to be a desirable course of action.

Q What were they doing for those weeks?

A Well, they continued to deliver out their customers' accounts. That was their biggest activity. They also had some production from Murray McDonnell and a few other people

who were left in the firm, and they continued to do their rights business on the floor, but that was guaranteed by Scheinman, Hochstein & Trotta.

MR. BROOKS: Thank you, sir. I have no further questions.

Q Sir, I will just start with a little routine matter. I show you Exhibit 000 that was marked this morning, a letter from yourself to Mr. Sporkin and just ask you which file did that turn up in?

A I think that turned up in a file of letters to the SEC.

Q I take it that file was not turned over to the attorneys for the plaintiffs before this time.

A That's my understanding.

Q What period of time do those letters to the SEC cover?

A I don't know.

Q 1968, '69?

MR. BROOKS: I object to the inquiry. I represented to the court that I was the fellow that scouted out the request in Mr. Beebe's subpoena. This witness has no first-hand knowledge.

THE COURT: What's the purpose of this line?

MR. BEEBE: As I remember, I was going to be allowed to look into those letters and find out if there was anything that needed cross-examination. Therefore, the first thing I would like to do si get those files and any references to McDonnell & Co. in the period from January 1, 1968, to December 31, 1970, and I would like those produced as

promptly as possible so we have a chance to examine them.

THE COURT: Any further letters referring to McDonnell in this file from which OOO came?

MR. BROOKS: When I reviewed the files, your Honor, I was responding to Mr. Beebe's trial subpoena of a day or so before the trial. I don't recall any other letters to McDonnell & Company other than the ones I have already produced for him in response to the subpoena. I pulled this one out because it struck my eye --

THE COURT: My question is were there any others here that Mr. Beebe does not have access to that you know of?

MR. BROOKS: Not that I recall.

MR. BEEBE: I would still like access to that correspondence file between the stock exchange and the SEC of 1968, '69 and '70.

THE COURT: Where is the file from which this was pulled?

MR. BROOKS: Where is it?

THE COURT: Yes.

MR. BROOKS: Well, Mr. Bishop's secretary made available to me a number of files to try to respond to Mr. Beebe's trial subpoena. When I was done going through them, I gave them back to her.

MR. BEEBE: 11 Wall Street, I guess is the answer.

THE COURT: Do you know what sides they are?

MR. BROOKS: What sides they are?

THE COURT: Is it 1 inch, 2, 3 inches?

MR. BROOKS: The files I went through were maybe 2 inches thick for each year, I believe, that I went through them. I forget what years Mr. Beebe's subpoena inquired into.

MR. BEEBE: May I have access to them this evening or tomorrow morning? That would solve the problem.

MR. BROOKS: I certainly would object to producing any part of the file that doesn't relate to McDonnell.

THE COURT: I would agree.

MR. BEEBE: I have no interest to anything which relates beyond McDonnell & Company in those three years.

THE COURT: We will take this up further during lunch.

BY MR. BEEBE:

Q Sir, I may skip around a little. I will try to make the questions as coherent as possible.

I believe early on yesterday you testified concerning the exchange's responsibility for upholding commercial honor and integrity. In whose interests does the --

A I don't recognize that characterization of my

testimony.

Q Well, I will just ask you right now.

THE COURT: How about just and equitable principles of trade, would the witness accept that?

THE WITNESS: Yes.

THE COURT: All right.

Q In whose interests does the exchange uphold the just and equitable interests of the trade?

A I think in relation to each other and those with whom we do business.

Q Would that include subordinated lenders to member firms?

A Certainly in some respects, yes.

Q In what respects would it not?

A Whatever we know about them we would expect just and equitable principles of trade to be followed in whatever the member firm does.

Q Now, we have mentioned trusts, there are some trusts involved here. When a trust is involved in lending money to a member firm was it standard operating procedure at the exchange to review the trusts authority to enter into the transaction?

A Yes.

Q Was there any effect on other member firms when

McDonnell & Company went out of business?

MR. BROOKS: I object to the question, your Honor. I think it is much too broad.

THE COURT: Yes, I sustain the objection.

Q Do you know of any effect on the other member firms from McDonnell going out of business?

A I suppose some of them could have lost minor amounts of money.

Q Did the other firms through the special trust fund pay money for the assistance of McDonnell's customers, this seven to nine million dollars you just talked about?

A I think not in any direct way.

Q I mean indirectly.

A Well, no. I think they were practically all exchange revenues which belonged to the members of the exchange, not to the member firms.

MR. BEEBE: May I have that answer read back?

THE COURT: Mr. Beebe, let me ask you, is there any dispute about the source of the trust fund money, because we went through this with Mr. Arning, as I remember, in quite some detail on cross-examination.

MR. BEEBE: Perhaps the witness could put that to rest altogether.

Q This special trust fund money comes from the

other member firms; right?

A No.

MR. BEEBE: Then there is some dispute.

Q What is the source of the special trust fund?

THE COURT: Mr. Arning testified to this in substantial detail on cross-examination as to where the revenues came from.

MR. BEEBE: Yes, and there is still a substantial dispute.

THE COURT: What is the dispute?

MR. BEEBE: That the funds came from other member firms.

MR. BROOKS: Nobody has disputed that on the record except Mr. Beebe.

THE COURT: As I understand it, the money came from certain rentals of privileges, if I am characterizing it correctly. But that the payers of the rentals were the member firms.

MR. BEEBE: As long as it is clear that the source of the funds, all the funds in the special trust fund were ultimately from member firms.

THE WITNESS: That's not true.

THE COURT: Go ahead.

Q Well, sir, you gave a deposition in this case,

did you not?

A Yes.

Q April 24, 19 --

THE COURT: Mr. Beebe, you don't have to get to that, unless you are going to contradict this last answer.

MR. BEEBE: I was going to do that, sir.

THE COURT: Yes.

THE WITNESS: Would the reporter please note that question that I answered. If I am going to be contradicted I might want to hear it again. Just note where it is.

Q Your recollection might have been a little better back in 1973, sir.

A Let's find out.

Q That's what I am trying to do.

This is at page 37.

"I am talking about McDonnell and I'm asking what effect the demise of McDonnell & Company had upon the other member firms.

"A Well, I don't think the other member firms lost any significant sum of money as a result of it except what was indirectly paid by the exchange for the assistance of McDonnell's customers."

A I think that's consistent with my previous answer.

Q That's my question. What was paid indirectly

by the exchange for the assistance of McDonnell's customers? Wasn't it the trust fund funds?

A That's a different question than you have been asking me.

Q What is the answer to this question?

A Could I hear the question clearly, please?

MR. BEEBE: Read it back, please.

(Question read)

Q That was my original question to you.

A I'm sorry, I still don't understand that question.

THE COURT: Keep reading.

(Next question read.)

THE COURT: If I could, in the interest of saving time, bring us up to a point. Mr. Bishop said that not all the money that came into the trust fund came in directly from the members. Am I correct on that?

THE WITNESS: Yes.

THE COURT: Explore as to the source of the money that did not come in directly from the members.

MR. BEEBE: I am trying to get tat the magnitude of the thing, your Honor.

THE COURT: Ask where it came from.

Q Any time is convenient for you, 1964, 1968, 1969 --

THE COURT: Let's just take his answer. He said some money didn't come in directly.

Where did the money come from then?

THE WITNESS: About a third of the revenues of the exchange come from the listed companies of the exchange. Now, that is part that did not come from member firms. Some of that income from the listed companies flowed through the exchange to the special trust fund.

THE COURT: Listed companies, by that you mean the companies whose stocks were traded on the exchange?

THE WITNESS: Yes. They pay listing fees to the exchange.

Q Following up on his Honor's question, what portion of the special trust fund was funded by non-member sources?

A I can't tell because it would all be indirect, flowing through the exchange.

Q Is it fair to say that a substantial portion of the special trust fund comes from sources from the member firms?

A Yes, flowing through the exchange, of course.

Q I am talking about the ultimate source was the member firms; is that right?

A The exchange's revenue sources to a considerable

extent come from member firms. As a matter of fact, a major source of those member firm incomes come from customers of those member firms.

Q I am not going to pursue that any further or we will get back here into the courtroom.

Sir, Exhibit 83 is a statement entitled "Statement of facts, October 22, 1970." There was some discussion about that this morning. Do you still have a copy of that in front of you? I will give you a copy (handing).

MR. BROOKS: That's the one with the coffee stain on it.

MR. BEEBE: You are right.

Q My question is in regard to Rule 342 pertaining to supervision and control which, according to this statement of facts by the Department of Member Firms had been violated, could you describe when the failure to supervise began?

A Probably around the time of the death of Mr. McKay. That's a difficult question to answer, but probably.

Q Well, you did answer it once before in the deposition, and I am going to read that to you again. Page 63.

You have had a chance to study this deposition before today, haven't you?

A I read it about four weeks ago.

Q Page 63.

"Q Yet you do feel it was clear that McDonnell was having a problem in supervision?

"Mr. Brooks: When?

"Mr. Dissick: The same period.

"Mr. Brooks: The same period covers five years the way you are defining it.

"Mr. Dissick: That's right.

"A No, I do not think they were, say, until apparently with the death of Sean McDonnell it started in one area, and with the death of Mr. McKay, another one."

Is that right? You gave that answer under oath back in 1973, didn't you?

A I think that I have refreshed my memory better now on those events than I had done. So I will stick with my present answer. I think that's what my recollection was at that time.

Q And after you gave your testimony under oath there was a time when this transcript was handed to you and delivered to you for review and signature; isn't that true?

A That's true. Well, I'm not really sure, but it's customary. Probably.

Q You swore to this on March 6, 1975, did you not? 1975 I emphasize; is that right?

A Well, I'm surprised that it's so recent. But I didn't do any refreshing of myself -- let's see, March 6, 1975? I don't think I had done any refreshing of myself before I read this. So I stick with my previous answer.

Q What was it, sir, between April 1973, March 1975 ar today, May 15, 1975, that you did which refreshed your recollection and changed your testimony?

A I have read the files --

MR. BROOKS: I object to the question, change his testimony. I think his testimony today is consistent with the deposition testimony Mr. Beebe read.

THE COURT: I will sustain an objection to the form of the question.

Q What have you done to refresh your

recollection?

A I have read in the files, I have sat here for three weeks, I believe, and that's done quite a bit in refreshing me.

Q So now you say it was not with the death of Sean McDonnell thatthe problem in supervision began?

A I will let the charges stand for themselves. They are really the best.

Q But that wasn't my question.

THE COURT: He has already answered that, Mr. Beebe.

MR. BEEBE: As long as we have it clear that it was not the death of Sean McDonnell that started this off according to Mr. Bishop as he sits here, I will move on.

THE COURT: The question has already been answered which triggered off this whole line of inquiry.

Q When did Sean McDonnell die?

A In the summer of 1968.

Q Did the stock exchange divide capital contributors into two groups; that is, active participants in the company and inactive ones?

MR. BROOKS: I object to the question, your

Honor. Divided into two groups for what purpose?

MR. BEEBE: For any purpose.

THE COURT: Overruled.

A For some purposes, yes.

Q Were the active ones required to apply for allied membership?

A I don't think I am remembering what you mean by the active ones.

Q The active capital contributors.

A No.

Q Maybe I lost something here.

A I have answered your question accurately.

Q Who is required to apply for allied membership in the stock exchange within this community of stock exchange people?

MR. BROOKS: I object. The rules are in evidence and they are the best evidence of what is required.

THE COURT: Read the question back.

(Question read)

MR. BEEBE: I can take the last part out, "within this community."

MR. BROOKS: I think that is in the rules that Mr. Beebe put in evidence as Exhibit 34.

MR. BEEBE: I'm sure it is but I would like the same breadth in asking on cross that was obtained on direct.

MR. BROOKS: I made no inquiry into this area.

THE COURT: Mr. Beebe, let's not make comparisons of that kind because I rule in my best judgment on each question and I'm not giving anyone any more latitude than I feel the law permits on any given question. So it isn't a question of giving one side privileges I am not giving to another. I rule as requested on each application that's put before me.

If you want to establish what the rules are as a foundation to going on to something else, and it's simple to do it by asking this gentleman if he has an awareness of it, I will permit you to do it. If it's simply to put the rules to the jury, because it's they that you are concerned about, that's another matter.

MR. BEEBE: I am trying to lay a foundation to go on to further inquiry in this area.

THE COURT: I will permit you to ask whetehr he is aware of the different character of people within the rules. If there is any problem, we will dig out the rules.

Go ahead.

Q Do you have the question in mind or shall I repose it?

A Why don't you repose it.

Q Who was required in 1968 and 1969 to apply for allied membership to the exchange?

A In a corporation, in a member corporation the voting stockholders. My memory could be incomplete but that is my memory.

Q Well, I guess that leads to the next question of who was required to be a voting stockholder.

THE COURT: Well, this gets us back to Mr. Brooks' objection which is itself set forth, I gather, in written form in some place.

MR. BROOKS: I made no inquiry in this area on my direct examination. I think it's improper for cross.

THE COURT: I'm not so sure this isn't legitimate cross-examination leading to something else.

MR. BEEBE: I am trying to lead to something else.

Let me see if I can quickly dig it out.

I will look at yesterday's transcript over lunch and perhaps come back to it.

Q Now, we have had some evidence introduced here about the debenture rollover in late 1968. Did the exchange take steps to insure as a matter of procedure at that time that a debenture was not counted as good capital after it became due?

MR. BROOKS: Again I object. I inquired not one whit about a debenture from this witness. Other witnesses have testified to it.

MR. BEEBE: As a party witness I am certainly allowed the greatest latitude in cross-examination, expecially in this instance.

MR. BROOKS: If he wants to call Mr. Bishop as his witness, he may.

THE COURT: I was going to say, you certainly have latitude --

MR. BEEBE: May we approach the bench, your Honor?

THE COURT: All right.

(At the side bar)

MR. BEEBE: As I understand it, sir, when you have a party witness, especially one who holds himself out as being the chief party witness, the areas of latitude on cross-examination are extremely broad and one can't be held to a sharp definition

of what exact question and words were used on direct. I don't think that is right.

MR. BROOKS: It has to be limited to the subject matter of direct on any cross-examination whether it's a party witness or not.

THE COURT: I am not aware of any such rule changing the normal rules of cross-examination as to an officer of the party. If you contend, and you may well contend, that this bears upon something else that he has to say, thatI will accept and I will permit you that latitude. But if this is just going off into a subject that you are developing on your own at this point to build your own record, I see no reason to do it on the cross-examination, particularly where the plaintiffs case here was the better part of two weeks.

This gentleman could have been called or you could have read his deposition as part of the case and then Mr. Brooks would in the normal course be dealing with your case. But now on the cross-examination of his last witness, if you are injecting an element into this which is really in the nature of some direct proof, I regard it as inappropriate.

I do want to say, Mr. Beebe, we are getting down to the tail end here and a lot of things this jury

has heard over and over and over again from one source or another. You are not the only one going over. Mr. Brooks has had his share of making sure everything gets known around here too. There are a lot of things we just don't need to go into again.

MR. BEEBE: I certainly am not going to bring out unnecessary matters that have been already put to bed. I was under the same impression as your Honor, that we had made it very clear that the source, for example, of the trust fund was traceable back to, in one way or another, to the members. When we turned to Mr. Bishop he denies it and I have to search in the deposition and bring it out again.

If this man tells me, Mr. Bishop tells me you have to put your questions exactly so, so and so, I will have to do it. I have no choice.

As far as bringing this out now or on rebuttal, certainly I can call him on rebuttal and he will be my first witness and we will have an overlap.

THE COURT: There is no rebuttal because you went into this with Mr. Arning, Mr. Schuette.

MR. BROOKS: Mr. McElroy.

MR. DUBIN: He is the chief executive officer of the party.

THE COURT: It was open to you to call him as your witness or open to you to read his deposition, Mr. Dubin.

MR. BEEBE: I think they brought out testimony on their case on rebuttal which attempts to refute some ofthe points I am going to be going into with this witness.

MR. BROOKS: When those come up we can talk about them. We are talking about the debenture and I didn't mention that.

THE COURT: I am prepared to give yousome latitude here.

MR. BEEBE: I won't take much.

THE COURT: I was in the service in World War II and out in the Pacific and we had bombed this one airfield and bombed it and bombed it and finally the fellow who was in charge of the photographic division, he said "Please don't go there any more. We have taken pictures of both sides of the airfield bombed one way and bombed the other way."

MR. BEEBE: Yes, sir.

THE COURT: All right.

(In open court)

MR. BEEBE: I believe there was one pending

question in this area.

THE COURT: You go ahead and put this line.

MR. BEEBE: Shall I pose it once more?

THE COURT: Yes. Let's go forward consistent with our colloquy at the side bar.

Q Did the exchange take steps to insure as a matter of procedure in late 1968 that a debenture was not counted as good capital after it became due?

A There would come a time when we would. I'm not sure that it would be immediately. When the next financial questionnaire came in, if it listed a debenture that our records showed to have expired I think we would have noticed it then.

Q Did the exchange make any attempt to verify what McDonnell & Company told to Mrs. Anna McDonnell, one of the plaintiffs in this case, or Mrs. Murphy in late January or late February 1969?

A No.

MR. BROOKS: I object. It hasn't been established that the exchange knew what, if anything, was told to these two ladies.

THE COURT: I will permit the answer to stand. No matter what was said to them, I take it, if anything, you did not investigate that?

THE WITNESS: Correct.

Q Sir, there came a time when McDonnell & Company issued a press release in about August 1969. Do you recall that?

A I have heard it spoken of at this trial, yes.

Q Do you recall it from prior to this trial?

A Yes.

Q Did you see that press release after it was sent over by -- still in press release form, after it was sent over by McDonnell & Company?

A Yes.

MR. BROOKS: I am not sure I understand what he means in press release form. Do you mean before it was published?

MR. BEEBE: Before it was published by the newspaper.

THE WITNESS: I didn't understand that.

Q Did you see it before it was published in the newspaper?

A I don't recall that. I don't know.

Q Did you see the press release that McDonnell & Company issued?

A I have seen the one that was in our file, yes.

Q I mean at or about the time it was issued, say August 1969.

A I believe I did.

Q I show you Exhibit 60A in evidence, and a better copy, nd ask you fromthe better copy if you can make out your B above Fred Stock's initial underneath?

A Yes, I do.

Q Were the statements in that press release accurate at the time you received it?

MR. BROOKS: Your Honor, I don't know that there is a foundation for this witness to answer that of his own knowledge.

MR. BEEBE: It was examined in the deposition. He answered at that time.

THE COURT: I will overrule the objection.

I will sustain the objection to the form of the question. You may ask him what he knew about the release at various times.

Q Did you know in August 1969 whether or not that press release was accurate?

MR. BROOKS: Same question, same objection.

Q Or do you know of anything that was inaccurate about it.

THE COURT: Sustained as to all of them as

to form.

Q Having had a chance to review that, sir, before today and as you sit here now, can you recollect what in your mind was your reaction when in 1969 you received that press release?

A No, I cannot recollect it.

Q Are there, sitting here now reviewing it, based on what you know now, are there any misstatements in that press release?

MR. BROOKS: I object.

THE COURT: Yes, sustained.

Q What did the stock exchange do after receiving that press release on August 1, 1969?

A I don't recall --

THE COURT: With regard to the release?

MR. BEEBE: Yes.

A I don't recall having done anything.

Q Do you recall if anyone else at the stock exchange did anything after receiving that release?

A No, I don't have any recollection.

Q Do you recall from earlier testimony that a newspaper article appeared the next day?

A I believe I saw a clipping of it in our file.

Q Containing substantially the same things that were in the press release?

A No, I think it went a long way beyond the press release.

MR. BEEBE: Well, we have it in evidence. We can dig it out.

MR. BROOKS: Your Honor, I think I will object.

This inquiry about the press release is both beyond the scope of the direct examination and it is repetitive of the testimony of a number of witnesses we have heard before on this press release.

MR. BEEBE: I don't believe this is repetitive in the sense that we have been trying to find out what actions were or were not taken when the exchange had or didn't have certain knowledge, and that issue was very firmly and thoroughly raised.

THE COURT: I am going to sustain the objection along this line. You could have called Mr. Bishop on your own case for this purpose.

If you find that it is irrelevant you may call him thereafter.

MR. BEEBER: Very well, sir.

THE COURT: I sustain the objection.

BY MR. BEEBE:

Q Were you in charge in 1968 of the arbitrage area?

A There wasn't any such area as the arbitrage area.

Q Did you know anything about the problem of arbitrage in 1968?

A Yes.

Q Did you know anything about arbitrage in early 1968?

MR. BROCKS: Your Honor, is this a question in general or does it relate to the arbitrage problem we have in this case?

MR. BEEBE: It is directly related to the arbitrage problem of McDonnell & Company.

A I have not been answering it on that basis. I have been answering the questions.

Q Did you know anything about the arbitrage problem--well, I will ask it broadly: Did you know anything about how arbitrage was handled in early 1968, not limiting it at the moment to McDonnell & Company?

A I was fairly expert with arbitrage. I have been familiar with it for many years.

You haven't asked me any questions about McDonnell.

THE COURT: He will. Just be patient.

MR. BEEBE: I think I mentioned that I will never refuse a reasonable offer.

BY MR. BEEBE:

Q Did arbitrage first come up as a problem with McDonnell & Company in 1966 or thereabouts?

A Our files indicate that.

Q Did you know anything about the problem at McDonnell & Company between then and early 1968?

A I don't recall that.

Q If I suggested you were a little firmer in your deposition, might that refresh your recollection?

A Let's try.

Q Answer on page 187:

"To the best of my knowledge I knew nothing about this problem at that time."

MR. BROOKS: That is exactly what he said here, your Honor.

A That was my recollection then and that is my recollection now.

Q I think that is slightly stronger.

THE COURT: It is the jury's determination that will govern, and it is their duty to make such determinations.

BY MR. BEEBE:

Q There has been some testimony about exchange constitution article 13. Do you recall that?

A I recall that it has been mentioned.

Q And was one of the purposes of amending article 13 to strengthen the exchange's hand so that it could impose measures for severe operational problems?

A That has a familiar ring but I don't think it is exact.

Q Well, it may have a familiar ring, because in

answer to a question on this subject in your deposition on page 219 you said:

"I think the most significant thing about it says at the end of page 5 just the existence expressly powers"-- I think that should be "express powers to suspend would strengthen the hand of the exchange in imposing measures short of suspension and member organizations suffering severe operational problems."

A I knew it wasn't exact because this is different as you said it before.

Q Well, this was your testimony, wasn't it?

A Yes, that is what my testimony was.

Q Did the exchange use that provision at any time in 1968 and 1969 to suspend McDonnell & Company?

A I don't believe that's what you just read. We did not suspend McDonnell.

Q Your answer is that you did not suspend McDonnell?

A That's correct.

THE COURT: Mr. Beebe, will you be going on to another subject now?

MR. BEEBE: Several, sir.

THE COURT: Very well, we will take our luncheon recess until 2 o'clock.

(Recess to 2 P.M.)

AFTERNOON SESSION

2 P.M.

(In the courtroom in the absence of the jury.)

THE COURT: Come up to the bench, gentlemen.

(At the bench.)

THE COURT: I just wanted to disclose that certain members of the jury invited my bailiff to lunch with them and he accepted, which I told him in the future he should discourage. He says they only talked about matters of food and things of that kind, but I thought I should make it a matter of record.

MR. BROOKS: We would have no objection to that.

THE COURT: No problem with that?

MR. BEEBE: No problem.

THE COURT: Next, I am very troubled by this juror number 4 who has been increasingly observed by me to be dozing. Since the first day when you spoke to me about this I have observed myself; I have seen it happen from time to time.

This is a very congenial jury, I learned through my law clerk. They brought in food and they brought in coffee making equipment. It is the only jury I ever had where for three weeks in a row everybody was here on the second; it is a very collegial kind of jury, and therefore

slh2

I am concerned a little bit if I excuse her, which there would appear to be grounds for, about whether this would cause some dislocation, perhaps, in the relationships in the jury.

On the other hand, it would appear from what I have observed, and perhaps what you gentlemen have observed, she has not really been attentive enough to adequately perform her duties.

Now, what guidance do I get from counsel?

MR. BEEBE: May I make a small suggestion, in terms of the personal relations of the human beings here involved, since we only have a day or so to go before summations, that after the factual cases are in on both sides, perhaps that would be an appropriate time to do it if these observations continue.

THE COURT: Well, let's see how we feel when we get down to the end. I am a little bit disturbed at what I have seen thus far, not that it is not with all the good will in the world, and this is not the typical kind of a case where somebody is sleeping because they want to sleep. I feel this woman just has not been able to keep her attention up.

MR. BROOKS: It may be she is working at her normal job in the evening.

slh3

THE COURT: No, I gather not. My clerk tells me that she is not.

MR. BROOKS: It is a boring case.

THE COURT: Certain aspects of it I am sure for certain people would have a certain tedium. Let's put it that way.

MR. BEEBE: Personally I found it fascinating but I could sympathize with that view.

THE COURT: Well, unless you have thoughts to the contrary I would be inclined to excuse her either at the end of the day or on Monday.

MR. BROOKS: I don't have a thought to the contrary.

MR. STEIN: I agree with your Honor; I think she should be excused.

THE COURT: Mr. Beebe, what is your thought?

MR. BEEBE: I think I would go along with that.

THE COURT: All right, I think I will do that either at the end of the day or the first thing Monday morning, probably at the end of the day.

All right, bring the jury in.

(The jury entered the courtroom.)

R O B E R T M. B I S H O P, resumed.

MR. BEEBE: One prefatory word.

I thought before the lunch hour we were going

to resolve at the lunch hour the question of those SEC files.

How was that left?

THE COURT: Well, let's take it up during the break.

MR. BEEBE: All right.

CROSS EXAMINATION CONTINUED

BY MR. BEEBE:

Q Sir, in 1968 was there a committee on which you were on at the stock exchange known as the Restriction Committee?

A Yes.

Q When was that set up?

A Probably April, 1968.

Q And you were a member of that?

A I was appointer and its chief.

Q Appointer?

A Yes.

Q It was your committee?

A It was my committee.

Q What was the purpose of the committee?

A It was to counsel me on what firms we would put on restriction, and, if so, what restrictions.

Q Would the subject of McDonnell & Company from

time to time cross the agenda of that committee in 1968?

A I don't recall any reason why it should have been.

Q McDonnell & Company was placed under restrictions in April, was it not?

A Oh, I don't believe I had set up that committee at that time.

Q You maintained a diary, did you not, in 1968 and 1969?

A I don't think that is a very good word to call it. I kept a calendar of appointments.

MR. BEEBE: May we have those?

MR. BROOKS: Yes. We have produced these diaries for you.

BY MR. BEEBE:

Q Here is 1968. I understand there are matters in here not pertaining to McDonnell & Company, and I just want to use this to refresh your recollection.

MR. BEEBE: So let's just mark it for identification for a moment.

(Marked Plaintiffs' Exhibit 95 for identification.)

Q Now, just to give us a frame of reference, as I recall Lybrand started the audit on or about October 31, 1968.

Will you turn to the page of November 6, 1968?

A Yes?

Q There is a reference in there to a Lybrand meeting.

A That is correct.

Q Was McDonnell & Company that Lybrand was in the process of auditing at that moment discussed at that meeting?

A I have no reason to think that it was.

Q Looking at the people who were in attendance with you at that meeting, according to the initials in your diary, would that indicate to you that Lybrand may have told you something about McDonnell & Company at that meeting?

A No.

Q Was Mr. Schuette the coordinator at McDonnell & Company at that time?

A Yes.

Q Did the coordinators keep you up to date on problems of member firms in general?

A Yes.

Q There is another meeting on November 25th with Lybrand. It says "Lybrand people 2 o'clock in the afternoon."

Was McDonnell & Company discussed at that meeting?

MR. BROOKS: Your Honor, I object. It is beyond the scope of the direct examination.

MR. BEEBE: Well, the subject of McDonnell & Company's audit in 1968, McDonnell & Company's problems late

in 1968 are all---

THE COURT: Yes, I will overrule that objection.

Go ahead.

A I have no reason to think so, from this entry.

Q Did you receive any indication directly or indirectly from Lybrand that Lybrand was going to find McDonnell & Company in violation of the net capital rule before you received Lybrand's audit in January, 1969?

A I believe it is a couple of days earlie .

Q No earlier than a couple of days, is that your testimony?

A It might have been three.

Q Three days earlier?

A Yes.

Q In any case, no earlier than, say, the 10th of January?

A No, I think it was the 9th.

Q What did you hear on the 9th of January?

A I don't remember what I heard. I know there is a memorandum indicating that there was some conversation on the 9th.

Q There has also been testimony that a Mr. Carlan got the word to Mr. Schuette some time before that?

A I don't think you are correct.

Q There has been testimony to that effect. I am just asking you --

A If there has been I think it is inaccurate.

MR. BROOKS: I don't think there has been testimony to that effect your Honor.

MR. BEEBE: Well, the record will speak for itself.

BY MR. BEEBE:

Q Did you hear from Mr. Schuette orally before January 9, 1969, that there was an indication that Lybrand might find a violation?

A I have no recollection of that, but there is nothing in our file to indicate it, if our file indicates that that is incorrect.

Q I'm sorry, you say your file indicates that that is incorrect?

A That is what I said.

Q I am talking about an oral conversation.

A The January 9th memo indicates to me that that was the first time on which we had that kind of indication.

Q You didn't hear anything before that, is that right?

A I said I can't recall.

Q While you have that in your hand, December 5, 1968, meeting with Mr. Schuette. Now --

A Just a minute, I don't see any meeting with Mr. Schuette on December 5th.

Q The Restriction Committee. Could you tell us who the first initials represented?

A It says THS. That is Thomas Shilson.

Q Do you know what the Restriction Committee discussed on December 5th, whether it included McDonnell & Company or not?

A No, I do not.

Q Now, the next page, sir, right next to the one you have, December 6th, "Restriction Committee"; then it does have Mr. Schuette's initials, does it not, HES?

A I think that is probably so.

Q Now, did you discuss the McDonnell Company with Mr. Schuette on that day?

A I don't know. He handled many other firms too. I believe it was our practice then to have different coordinators in to report on their firms, so he was probably reporting whoever we knew had a problem at that time, and I don't believe we knew that McDonnell did.

Q Did you yourself maintain at that time a file of official memoranda of correspondence, your official filing system?

A Having to do with McDonnell? No.

Q Having to do with what your functions were, your duties at the stock exchange.

A We had a little miscellaneous material in my file. Most of it was in the central records or in the member firm's department files.

Q Did you also maintain yourself a private personal file at that time?

A On what?

Q 1968, 1969.

A Yes, I had my income taxes and other matters.

Q Did you also have in your private personal file matters relating to telephone calls or meetings, notes, regarding your activities at the Department of Member Firms?

A I probably had some fragmentary ones.

Q What have you done with those notes since 1969, sir?

A I don't know which ones you're talking about.

Q The personal notes that you maintained on an informal basis, I assume --

MR. BROOKS: I object to this. He is making the witness his own and he is taking a fishing expedition as to documents that are not in evidence.

THE COURT: Where do you expect this to lead, Mr. Beebe?

MR. BEEBE: I don't expect it to go very much

further at all, just to find out if these documents indeed exist and where they are.

MR. BROOKS: This is discovery --

THE COURT: Yes, and this is not the time for discovery, at the trial. Now the location of his personal records is not relevant.

MR. BEEBE: I submit that if personal notes also reflect meetings that he had that bear upon McDonnell & Company, they are--

THE COURT: You didn't ask him that. Ask him that.

MR. BEEBE: Very well.

BY MR. BEEBE:

Q Included in those records were there any notes of meetings you held in your official capacity in 1968 and 1969?

A I doubt it very much.

MR. BROOKS: Your Honor, I thought the question was to be directed with respect to McDonnell & Company.

THE COURT: I understood that.

Q But, in any case, you doubt very much that there would be any notes pertaining to your official functions that you have maintained apart from official records; is that your testimony, sir, as you sit here?

A There might be some but I don't think on McDonnell.

Q You are not sure?

A I am not positive we have searched them to find McDonnell items and we didn't find any.

Q You have already searched them then?

A Yes.

Q Yesterday, you were asked about the reporting methods of the department of member firms. You said the staff usually visited once a year. Could the staff of the department of member firms visit a member firm more than once a year if it so desired?

A Yes.

Q Could it visit as often as it deemed necessary?

A Yes.

Q Could it make as thorough an examination of a member firm's books and records as it deemed necessary?

A Yes.

Q You also testified as to the SOQ, which I believe are reports submitted by the member firms to the department of starting in early April, 1968; is that right?

A I think I did testify somewhat as to that.

Q Did the examiners customarily analyze the SOQ's when they were sent to the department?

A When they were sent to the department?

Q To whom were the SOQ's submitted?

A Oh, when the SOQ's were sent to the department. No.

Q What was done with the SOQ's after they were submitted by the member firm?

A They were looked at by the coordinator's staff.

Q And did the coordinators make their own analysis of the information furnished by the member firm?

A I expect you would say that one way or another.

Q Did they reach their own conclusions concerning the validity or invalidity of the information furnished to them?

A No, I don't think they could do that.

Q Well, what analysis did they make of the SOQ's pertaining to the net capital in 1968?

A There was practically no information on net capital in the SOQ's. All there was was five figures The net worth and the ratio and proprietary positions, I think you couldn't do any analysis from those figures.

Q When you say the ratio, the ratio of what?

A Aggregate indebtedness to net capital.

Q Did the coordinators or examiners or anyone else at the New York Stock Exchange turn over any of those figures to the Securities and Exchange Commission in 1968?

A Yes.

Q And yesterday --

A Are we still talking about McDonnell?

Q We are talking about practice at the time.

A Okay.

Q I am including McDonnell in the question.

Yesterday you testified about arbitration proceedings at the New YorK Stock Exchange. How is the New York Stock Exchange arbitration panel composed?

A It depends on between whom the disputes are. If the dispute is between personnel and a member firm or an employee with a member firm, then it's heard by a panel of five people from the securities business.

Q Could I take it to the other supposition. Let's assume it's not an employee but it's someone who is, say, a subordinated lender.

A Then it's heard by a mixed panel who I think are three people from public life, you know, citizens, and two people from the member firm community.

Q Is it a panel somewhat like the array of a jury that has been selected and then out of that is chosen by lot the member of the particular board of arbitrators?

A Yes. The two parties have a chance to disqualify people on the initial panel given to them, and then from the remaining ones they are selected.

Q Now, you mentioned that two people are from the securities industry and three from public life on the final board. Isn't it true, sir, that the chairman of the board of governors of the New York Stock Exchange selects everyone in both panels from which are drawn the final board?

A Well, I know what you are driving at. That's not exactly literal though.

Q All I'm driving at is a question and answer.

A There are panels of maybe two or three hundred people on each panel who are people who have been accumulated over the years who were -- the constitutional provision is they are nominated by the chairman to the board to serve on the arbitration panels.

Now, in fact the chairman doesn't know those people in most instances. They are people the staff has gathered from various and sundry sources as worthy people.

Q The New York Stock Exchange selects the panel from which the arbitration board is drawn; is that right?

A Right.

Q You testified about the April 1968 restrictions along the lines that they were merely designed to shock McDonnell & Company.

Did you ever note that thought, about shocking McDonnell & Company or anything along those lines, in a memorandum?

A I did it in the letter to McDonnell as I testified yesterday.

Q Apart from the letter to McDonnell is there any other memorandum that would reflect what you testified yesterday about what was in your mind?

A I don't know of any.

Q You also testified to the effect that things improved after those restrictions were removed 17 days later, at first.

A I don't accept your characterization of my testimony.

Q Did things improve at McDonnell & Company after the restrictions were removed in April?

A Their explanations of what they were doing improved. I am uncertain at the moment as to whether

in the 17-day period the situation improved. I don't know that we had accurate reporting as of those two dates.

Q I am talking about following the removal of the restrictions, did things at McDonnell --

A I misunderstood. Now what's the question again?

Q Did things at McDonnell & Company improve after the restrictions were removed?

A Yes.

Q Did McDonnell and Company need to have restrictions reimposed shortly thereafter, I mean in a matter of two months, three months?

A No.

Q McDonnell & Company put voluntary restrictions on itself in July 1968, didn't they?

A Yes.

Q Was that something that the exchange encouraged?

A Yes.

Q Were those voluntary restrictions in writing, in the form of a letter or something like that?

A I'm quite sure they were. I believe we had -- well, we had a letter that referred to it, yes, sir.

As having come into us as an attachment, I believe, and I think we had probably had it earlier. I think they were reminding us at thattime. So I think yes.

Q Do we have that document available?

A I think it's one of the exhibits.

Q The later one is but is there one in July as an attachment or directly?

A I don't remember that.

MR. BEEBE: Are you aware of such a thing?

MR. BROOKS: I don't remember, Mr. Beebe. It could be there or it could not.

MR. BEEBE: I am just not aware of a writing in that July period.

Q You mentioned arbitrage, not arbitration but arbitrage, yesterday, and we have marked some exhibits, one of which was added yesterday, LLL, concerning this subject.

The exhibits go, I believe, from August 28, 1968, maybe as far back as August 20, 1968, Exhibit 73, into October on this subject. And yesterday's Exhibit LLL was dated September 4, 1968. How long had McDonnell & Company been a rights specialist at the New York Stock Exchange?

A For many years. I don't know how long.

Q Decases?

A It might have been.

Q It might have been going back into the teens; is that right?

A I don't know.

Q Had it ever needed -- McDonnell & Company ever needed a special interpretation under rule 325 beforethis time in connection with its arbitrage transactions?

MR. BROOKS: I object to the form of the question.

THE COURT: Sustained as to form.

Q The last exhibit I was referring to in the series is Exhibit 32, which is dated October 24, 1968.

Let me rephrase that queation. Before August 1968 had McDonnell & Company ever received or requested any position be taken by the exchange with regard to arbitrage and McDonnell's compliance with rule 325?

A I believe they had.

Q Do you know when that was, sir?

A What I remember is 1966.

Q What occurred in 1966 in this connection?

A I believe it was not resolved.

Q Well, I take it from that that McDonnell & Company requested that arbitrage be included at the trade date in 1966 and the question was left dangling and never concluded by the exchange; is that what you mean by not resolved?

A Well, I'm not really sure. I don't know the 1966 episode very well.

Q Was there a particular stock issue in the 1968 incident thattriggered this request by McDonnell & Co.?

A I believe that an examiner as of a particular date was concentrating on a particular security, because that's what happened to be expiring at that time, but I may be wrong.

Q Was it a general interpretation that they were seeking to reply to all situations that occurred?

A I think that's what they were seeking.

Q There is mention in some of these memos, at least one of them, concerning this thata suggestion is made that McDonnell & Company obtain more capital. How would the obtaining of more capital relate to their arbitrage interpretation?

A Well, they wouldn't need, they could get

along with less capital if the other interpretation were given.

Q And the obverse is also true, that if the favorable interpretation is not given they would need more capital; is that correct?

A Yes, at times.

Although I'm not sure that you had the opposite there. I think you have given me the same thing twice. Perhaps I wasn't listening hard enough.

Q Yesterday, sir, --

A Perhaps I ought to havethe last question read back.

THE COURT: Let's do that. Let's have the last question and answer read back.

(Question and answer read)

Q I did have it right, I think.

A Yes.

Q Yesterday, there was testimony and questioning about Exhibit 35A, which is a memorandum from yourself to Mr. Schuette dated November 7, 1968, typewritten memorandum. Do you recall that (handing)?

A Yes.

Q Do you want to hold on to it and I will get another copy?

A Yes.

Q You mentioned in your testimony yesterday that you had heard that seven or eight vice presidents had left since the death of Sean McDonnell and you thought they were "producing vice presidents." What made that thought cross your mind at that time?

A I didn't think they would have that many in the operations area for one thing.

Secondly, I thought I would have heard about it if they had been in the operations area. I think something what whoever told me led me to believe they were producers.

Q What was the source of your information, was it a rumor or a firm source?

A I haven't been able to remember that. I have been puzzling about it and I can't rememb er who told me that.

Q Is there any reason why you didn't make any notation in the memo that these were producing vice presidents?

A No.

Q Was the reduction of business for McDonnell & Company a good idea in November 1968?

A I wouldn't quarrel with the firm's decision

if they decided to do it, which I guess their restrictions did in a sense.

Q You testified yesterday that having these seven or eight vice presidents leave might help in reducing the amount of business. In 1968 when you wrote the memo did you feel that was a good thing to have happen for McDonnell & Company?

A I don't think I was thinking of that when I wrote this memo. I think I was thinking more of dissension within the officers of McDonnell.

Q Could you explain that?

A I was worried about whether their team was breaking up, with Sean having left.

Q What would be the consequences of their team breaking up?

A Lessen leadership in their sales efforts and their other control of the firm.

Q It would hurt operations; is that what you are saying?

A Not necessarily. You have to look into what vice presidents and what replacing they would bring in.

Q Could it reduce profits?

A Pardon?

Q Would it reduce their profits?

A Again it depends on the people.

Q Was that the kind of concern you had, though?

A No. I think my principal concern was in whether they had an internal falling apart of people.

Q What did you do to investigate whether or not your concern was warranted?

A I was interested principally in one aspect of it, and that was whether it was having an effect on their operations, and that's what I asked Mr. Schuette to to look into.

Q When it says in this memo that you wrote, "their operations and ocntrol is therefore said to be declining rapidly," what was the basis of your making that statement?

A I think I was just repeating what whoever had told me this said. That's why I used the phrase "said to be."

Q You still can't remember the source for that?

A No.

Q Now, apart from this little note on the bottom by Mr. Schuette that "The attached summaries will show the progress (and lack of it)," did Mr. Schuette submit anything else to you in writing later on after the

October MF6 and operations Q arrived, there referred to in his note?

A Well, in the first place you are mis-characterizing what I received because I received all the attachments, too.

Q I said you did.

A No, you didn't. You said when I received this paragraph at the bottom.

MR. BEEBE: Could we read back my question?

THE COURT: No. Let's go ahead. I don't think this is worth spending that time on, Mr. Beebe. Just put the question to the witness, please.

Q What, if anything, did you receive from Mr. Schuette after the October MF6 and operations Q, which I assume were McDonnell & Company documents, arrived at the stock exchange?

A I don't remember that.

Q Now, sir, yesterday you testified that occasionally the stock exchange had exercised article 13 of the constitution.

A Yes.

Q Could you name the occasions, please?

A In Ira Haupt & Co. we had. I thihk we did it

at Gregory and Company.

Q Gregory?

A Yes.

Q When was that?

A I don't remember.

Q After January 30, 1969 or before?

A I can't remember.

Q Yesterday you offered your impression that in late 1968 the company was well capitalized. Was it well capitalized inmid-January 1969?

A In mid-January 1969, that depends on your point of view. If you are looking at it from the standpoint of the exchange's rules in compliance with the capital requirement, no.

If from a net worth standpoint, yes.

(Pause)

Q Yesterday, sir, when you were mentioning that they were well capitalized in late 1968, which sense were you using, the net capital sense or the net worth sense?

A. From the knowledge of the exchange at that time I think both.

Q You indicated yesterday a great familiarity with the files that were involved in this matter and I

take it you have been attentive to the testimony in the case so far. I'd like to show you Exhibit 60, which is dated October 24, 1968. It's a memorandum from Mr. Newman to Mr. Jones. It was in connection with this arbitrage question. I direct your attention to the last paragraph, on October 24, 1968 the last paragraph read, "Why don't they bring in more capital?"

Were you aware in October 1968 that McDonnell & Company needed more capital?

A No.

Q I take it this Newman memo was not one of the things that reached your attention?

A Even if it did I wouldn't have drawn that conclusion.

Q Had you ever heard the suggestion befoer this memo that McDonnell & Company needed more capital?

MR. BROOKS: I object, your Honor. This memo doesn't suggest that at all.

THE COURT: Let me hear the question back.

(Question read)

THE COURT: Overruled.

THE WITNESS: Is there an open question?

THE COURT: Yes.

(Question read)

A No.

Q Yesterday there was introduced a little -- copy of a little handwritten note, Exhibit LLL. I show you my copy. I believe that's dated September 4. I believe you said that you had seen that at the time. Who were the two parties that were involved in that exchange?

A Mr. Waterbury and Mr. Newman.

Q I show you another copy of another little note which I believe is from Mr. Waterbury to Hank, who I believe is Mr. Newman, also dated September 4, 1968, also discussing the arbitrage question -- could we mark that?

A I can't read that.

Q Maybe we can get a better copy from the exchange.

(Plaintiffs' Exhibit 96 was marked for identification)

Q Do you recognize Mr. Waterbury's initial at the bottom, LEW?

A Yes.

Q So is it safe to assume that "Hank" was Mr. Newman?

A Yes.

MR. BEEBE: I offer that as plaintiffs' next exhibit; and if a more legible copy is available I would be glad to substitute it.

MR. BROOKS: Your Honor, Mr. Beebe can read it into the record, I think, without qualification that I would not object. I can't read this document as it now exists. Maybe we can find a better copy.

Our copy seems to be worse.

If the Court and Mr. Beebe are willing to accept a copy which Miss Solomon has written in words that cannot be made out on the Xerox, we will make this available, and we have no objection to it.

MR. BEEBE: Could I make a suggestion along this line, that we use this as a practical matter based on Mr. Brooks' suggestion, and then substitute either the original or a more legible retyped copy later?

THE COURT: Very good.

MR. BROOKS: Why don't you read it into the record?

MR. BEEBE: Well, I would like to read it myself

first because I could not read all the portions before either.

Would you mark this one in evidence.

(Plaintiffs' Exhibit 96 received in evidence.)

MR. BEEBE: Now, sir, I am going to read it into the record.

This is dated September 4, 1968.

"Once again we state that the treatment accorded these positions are in agreement with Rule 325, and, frankly, I don't seewhy we should attempt to change the rule because of McDonnell's activities in rights.

Other brokers have the same situation"--

THE COURT: Excuse me.

May I say that I understand that in the United States District Court in Honolulu that the lawyers appear in sport shirts open at the neck without loss of decorum in the court.

I would, therefore, say that if counsel would like to continue this afternoon in their shirt sleeves, I feel it would be entirely proper given the circumstances under which we are working.

If any counsel or any juror or Mr. Bishop or anybody feels so inclined, they may do so. The circumstances are very poor here this afternoon.

MR. BEEBE: Thank you very much your Honor.

THE COURT: Go right ahead.

MR. BEEBE: I will start this again and put it all together:

"Once again we state that the treatment accorded these positions are in agreement with Rule 325,and, frankly, I don't see why we should attempt to change the rule because of McDonnell's activities in rights.

Other brokers have the same situation, i.e., they are long various securities at any given date which would have been sold the regular way and are uncleared, and we should give the same prescribed treatment. If McDonnell's activities in this area are so large that it is necessary to get special treatment to meet capital requirements from them, I think they need more capital in their business."

Signed LEW.

MR. BEEBE:

Q Yesterday, sir, you testified that you had read or were aware of Exhibit LLL which is dated the same date from Mr. Newman to Mr. Waterbury on this same subject.

Were you also aware at that time of Exhibit 96, and I hand it to you again?

A Yes -- did you say at that time?

Q At that time, the same as you testified as to Exhibit LLL.

A I don't believe I testified yesterday that I saw these memos on the date of the memo. I saw them as a package somewhat later, perhaps a fairly significant amount of time later at the time that the decision was made by Mr. Arning in May.

Q The decision regarding arbitrage?

A Yes.

Q So in any case if we linked up the time of that decision, that would be the time when you saw those memos, or perhaps slightly before that?

A I don't like to commit to that without knowing what the time was. You're in the right ballpark.

Q You testified yesterday that McDonnell & Company had been a profitable company in 1967 and for the first eight months in 1968; do you recall that subject?

A Yes.

Q Did McDonnell & Company somewhat later in 1969 claim a tax refund, as you testified this afternoon?

A Yes -- let's see now, what year are we? 1969 did you say?

Q 1969, a tax refund for the prior year, is that right?

A I don't know what their fiscal year was. It would have been for a fiscal year.

MR. BROOKS: There has been no testimony that the tax refund was for the prior year.

THE COURT: Are you aware of such testimony, Mr. Beebe? Just that there was a tax refund; isn't that what the proof is?

MR. BROOKS: That is what I recall.

BY MR. BEEBE:

Q Was McDonnell & Company a profitable company for 1967, I believe you testified yesterday?

A I believe that is my recollection.

Q Had it been your testimony that McDonnell & Company had been a profitable company for several years before that as well?

A Yes.

Q What was the basis of the tax refund, do you know?

A I can only guess at that.

MR. BEEBE: I may have the document to help us out but I can't put my hands on it right now.

BY MR. BEEBE:

Q You also testified yesterday as to a meeting on January 29, 1969, where you told McDonnell & Company to raise funds --

MR. BROOKS: Your Honor, I object. That is not the proper characterization of what Mr. Bishop said yesterday.

THE COURT: Well, let's just address his attention to a meeting on January 29, 1969.

Go ahead.

Q You also testified in relation to that meeting, I believe, that the first time you learned that Mrs. Anna McDonnell was involved in contributing funds was a few days later when you received a letter to that effect, is that correct?

THE WITNESS: Could I hear that question over again?

THE COURT: Yes.

Mr. Reporter, will you please read the question.

(Question read.)

A I don't think it had any relation to that meeting.

Q Sir, you testified -- and I am quoting now from page 1987 -- and this is in regard to a letter to you dated January 30th marked as Exhibit CCC in evidence:

"Q If I may characterize the letter it advises you that there has been a deposit to the existing subordinated account of Anna McDonnell and a deposit to the existing subordinated account of Marjorie F. McDonnell.

Was this, sir, the first time you learned that there was to be or that such a deposit was in the wind?

"A Yes. The answer, from these people, yes."

THE COURT: What is your question?

Q My question is really in the nature of a summary question, that that was the first time he learned that Anna McDonnell was the first who was making that deposit.

A That is what I answered yesterday and I still stand by it.

Q When was the first time you learned that Mrs. Murphy made a subordinated loan or was going to make a subordinated loan to McDonnell & Company?

MR. BROOKS: Your Honor--

A I don't know that I did.

Q So is it fair to say that the New York Stock Exchange treated Mrs. McDonnell and Mrs. Murphy exactly the same way that they would have treated any other potential investors?

A I don't even think we knew they were potential investors. We treated them once they were investors in the same way we would anyone else.

Q Before you knew it I gather that they in all the world of people who might have been approached were treated no differently than anyone else?

MR. BROOKS: I object.

THE COURT: Yes, sustained.

Q Were they treated or were they given any more or less information at the behest of the stock exchange than anyone else?

MR. BROOKS: I object your Honor.

THE COURT: Sustained as to form.

MR. BEEBE: Your Honor, may I urge that this is permissible cross-examination on a very important area.

THE COURT: It is just the generality of this. What do you mean, at the behest of the stock exchange? I agree with you that this is an important area.

Q Did the stock exchange request that these people, Mrs. McDonnell and Mrs. Murphy be given any more or any less information than anyone else?

A No.

MR. BEEBE: I have found my income tax document.

Q Sir, I am marking for identification and I will show you a letter from Lybrand --

(Marked Plaintiffs' Exhibit 97 for identification.)

Q -- from Lybrand, the outside accountants, addressed to the New York Stock Exchange, dated February 7, 1969, discussing McDonnell & Company's -- apparently furnishing further information with regard to the October 31, 1968, audit,

and I offer that as the plaintiffs' next exhibit, and then I may ask a question or two about it.

MR. BROOKS: I don't think it has been identified, your Honor. He ought to do that before it is admitted into evidence.

MR. BEEBE: I believe that it comes from the stock exchange's files, and there is no question --

THE COURT: Well, I will tell you what we will do. Let's take a recess at this point, ladies and gentlemen, and I will speak to counsel for a minute about this exhibit.

And, Mr. Bishop, will you step outside the door for a minute while I have this conversation with the attorneys.

(Jury and witness leave the courtroom.)

THE COURT: My reaction is that this Exhibit 97 is being offered on the theory that Mr. Bishop was in error when he said McDonnell was profitable through the first eight months of 1968.

MR. BROOKS: That is right.

THE COURT: I don't see how this contradicts that in any way, shape or form.

MR. BROOKS: I don't see either.

MR. BEEBE: That is not why it is being offered.

MR. BROOKS: I don't think it necessarily contradict

it for operating income for the year.

THE COURT: Even if they had a loss in the last quarter and they anticipate filing a return in 1969, I don't see what relevance that has to the issues.

What is it being offered for?

MR. BEEBE: Sir, I think that my interpretation of this, from the face of it is that it says they have a loss and they are making a claim on it, a loss for the year ended December 31, 1968.

Now, we have had testimony, lots of it, elicited by the exchange that this was a very profitable company. The profits continue through the first eight months of 1968, and the jury may have the impression that it continued through 1968. There is a very clear indication here that it is just the contrary; that in the last four months things collapsed so badly that they could file for a loss for the entire year --

MR. BROOKS: I don't think it shows that.

MR. BEEBE: -- and I think that's clearly what happened.

THE COURT: Unless this is in some way better sponsored than being in some way a statement of Lybrand as to what they intend to file for, based, I take it, on an estimate of the loss for the year, I don't see that

this really is admissible, because this is a self-serving statement of McDonnell & Company's auditors, which is an estimate, and is, therefore, not before us as a statement of fact.

MR. BEEBE: I have got a lot of, it seems to me, ammunition that this is a perfectly good document that I dug up last night when we had this problem about profits or not. They are notes that say that the claim was filed, little handwritten notes, that it was filed, on January 13, 1968, and that it was definitely sent to the stock exchange, so that they had notice of it, and--

THE COURT: But that doesn't make it a statement of fact.

MR. BEEBE: It doesn't make it a statement of fact?

THE COURT: Not authenticated as a statement of fact. The corporation's estimate of the loss; that is what it says.

MR. BEEBE: Yes, sir, and they filed a claim based on it, and also that claim comes very much to the fore when later on somehow through walking Milbank's lawyers through Andover, Mass., and whatever happened, according to the testimony this morning, this became somehow good capital.

I agree it is pretty shaky to become good capital, but that is apparently exactly what did happen, and that also

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makes it relevant.

THE COURT: No, I will not allow this exhibit on the foundation that has been presently laid.

(Recess.)

(In open court; jury not present)

MR. BEEBE: In the course of preparation of this I made a request to Milbank Tweed to produce certain documents and received a letter from Mr. Brooks dated March 19, 1975, which said, in part:

"Any document which I discovered to be in the files of the exchange which is in response to plaintiffs' rule 34 request and which was not previously produced will be produced when and if we find it."

Your Honor, I believe that since this is going to carry over until Monday it makes sense for Mr. Brooks to fulfill that and for us to have access to the files that the witness identified insofar as they pertin to McDonnell & Co. for 1968, '69 and '70.

THE COURT: Do I understand Mr. Brooks has said on the record already that except for this one document he doesn't know of any others that fall within the turnoverable category; is that correct?

MR. BROOKS: That's correct, your Honor. Let me tell you how I came upon this to set the scene a little better. On the eve of the trial Mr. Beebe served a trial subpoena on us seeking some general kinds of letters that had been exchanged between the SEC and the exchange, having nothing to do with McDonnell.

I suspected that they were to lay a foundation for some expert witness, as did appear.

I looked for those and found almost all of them. I did that through an SEC file. When I was going through that file I noticed this particular exhibit which had the footnote about McDonnell & Company. I noted it because of the footnote. I pulled it out at that time, put it in my bag. When the issue developed as to whether exchange restrictions were the same as self imposed restrictions I decided that it would advance the trial to put that in as an exhibit and did it.

I probably was a day or so late in giving it to Mr. Beebe between the time I decided that it was relevant and the time I put it in . Other than that, I recall no other McDonnell documents in those general SEC filed.

MR. BEEBE: My point is not the day or so later of course, my point is I believe from Mr. Brooks' recitation from now, and also my experience with going through very voluminous files when I worked on the IBM case and other cases, one does not go through a file from January through December unless one is requested to do so. All I'm requesting, since this witness has testified extensively that he communicated with the SEC

and was in regular communication, they look through this same file tonight or tomorrow morning and find out and ascertain whether or not there are any other responsive documents in it, because I don't think they did do that search yet. That's all I'm asking.

MR. BROOKS: I object to doing that, your Honor.

THE COURT: I gather it's already been done.

MR. BROOKS: I believe it has.

THE COURT: This was the run-through that pulled up Exhibit OOO.

MR. BEEBE: I think it pulled through because it happened to be where he was pulling out another document. Not that he ran through the time period involved. It's hard for me to conceive that that file would only have one document referring to McDonnell & Company between the New York Stock Exchange and the SEC.

THE COURT: I gather it didn't. I gather there were a number of others and you have already received them.

MR. BEEBE: We have not received extensive correspondence, if any.

MR. DUBIN: I did the document reproduction

and I can state to the best of my recollection I never received any other letter between the New York Stock Exchange and the SEC except that which Mr. Brooks adduced today.

MR. BROOKS: Let me correct Mr. Dubin. He was not even employed by Davis & Cox when the request was made. Mr. Becker went through the entire McDonnell file, which fills the floor of a room, he selected some documents to copy and he left others not for copy. There was lots made available to that gentleman which Mr. Dubin couldn't have seen. That was the choice ofthe plaintiffs' lawsuit.

MR. BEEBE: I don't think that pertains to this particular search because it was admitted on the record that this document came from a file that was not produced.

THE COURT: I'm not clear that you have a right to do this at this time. If it's only a two-inch file, let's do it and then there is no question about failure to disclose.

I gather that's two inches of correspondence?

MR. BROOKS: If its two years, it would be two two-inch files.

THE COURT: Can somebody do that subject to

somebody else's surveillance? This doesn't mean that you, Mr. Brooks, have to spend the evening looking at it. Mr. Bishop's secretary perhaps.

MR. BROOKS: I have to get the files from Mr. Bishop's secretary.

THE COURT: She can go through them and pull out anything that refers to McDonnell.

Can she do that between now and Monday?

THE WITNESS: By Monday probably.

MR. BROOKS: We will do that.

THE COURT: Incidentally, when are we going to finish the proof? How much longer will you be with this gentleman?

MR. BEEBE: It will lapse a little into Monday and then I don't have much on rebuttal at all.

THE COURT: You would be prepared to sum up late in the morning on Monday?

MR. BEEBE: At worst early in the afternoon.

THE COURT: That would be worse. Can you make it late in the morning?

MR. BEEBE: I will bend every effort and trust that there is not a good deal of redirect or what have you.

THE COURT: Bring in the jury.

MR. BEEBE: Since we are going on to Monday, is it agreeable to break on time this afternoon?

THE COURT: We are going to break at 4:30. A juror has requested that in addition.

BY MR. BEEBE:

Q Turning to the second page of Exhibit 97 for identification, do you recognize either or both of the two individual signatures below there?

A I recognized Mr. McKay's signature.

Q He was with McDonnell & Company at the time?

A Yes.

Q Did you at any time receive or review this document?

A I don't ever recall having seen this before.

MR. BEEBE: I offer this document now as an admission by McDonnell & Company bearing, as it does, its accountant's signature and Mr. McKay's signature.

MR. BROOKS: I object,your Honor.

THE COURT: Now, let me ask you -- I am not going to admit it against the stock exchange. What does it prove against McDonnell & Company?

MR. BEEBE: Virtually all the same issues are

joined against McDonnell & Company and the question of the filings that are stated in here are, of course, admissible --

THE COURT: Mr. Stein, an exhibit is being offered against your client on the foundation that it's signed by Mr. McKay. I asked Mr. Beebe to tell me what issues it bears upon.

MR. STEIN: I have no objection to the document coming in.

I note, your Honor, there appears to be a signature of Thomas McKay. If it's been identified, as I understand it has, I understood there was an identification.

THE COURT: Well, I will then permit it to be received atainst McDonnell & Company but it's not received against the New York Stock Exchange.

Ladies and gentlemen, this puts you in an anomalous position. Exhibit 97 is a letter from McDonnell to the stock exchange and on this state of the record you may only consider the contents against McDonnell & Company and against no one else. I will give you more on that when we get down to the charge of the case.

On that basis it's received.

(Plaintiffs' Exhibit 97 was received in

evidence)

Q Did McDonnell & Company have a loss for the year that ended December 31, 1968?

A I believe they reported a profit to us.

Q Would you --

A I don't know what they had.

Q Would you direct your attention to the third paragraph of this Exhibit 98, the first sentence. Would that cause you perhaps or remind you of what their profit or loss picture was?

A No. This sentence speaks of reporting --

THE COURT: The answer is no, Mr. Bishop. Next question.

Q What causes you to believe that they had a profit for the year 1968, sir?

MR. BROOKS: I object, sir. He told us that they reported it to the exchange.

Q Was that in a writing reported to the exchange, sir?

A I believe it was.

Q Could you pinpoint that for us, what writing that was?

A I believe they report it in their income and expense statement.

Q You mentioned income and expense statements yesterday. When aer they filed?

A They are filed in the late winter or spring of the year for the previous year.

Q Was an income and expense statement filed for the year 1968 for McDonnell & Co. in the spring or late winter of 1969?

A It's my impression that it was. I'm not positive.

Q Have you in reviewing the documents for this trial come across such an item?

A That's where I get the impression that I don't remember specifically, but I have an impression that I did see such a document.

MR. BEEBE: May I ask that such a document be made available if it's readily available?

MR. BROOKS: I have it right here, Mr. Beebe.

(Pause)

Q You testified, I believe, that the firm made a profit in the first eight months, it was your understanding, of 1968. Could you give the jury the ordre of magnitude of that profit?

A No.

Q I show you a handwritten document and ask you if you can identify it?

(Plaintiffs' Exhibit 98 was marked for identification)

Q Can you identify that, sir?

A I recognize this as a document I have seen in our files. It isn't eight months.

Q I am simply asking if you could identify what that document is.

A It's what its title says.

Q Could you just tell us what the title says?

A It says "McDonnell & Co., Inc., overall profits per INE report, 1966 to 1968."

Q Have you seen in the course of your preparation for this trial nay document reflecting the profits for the first eight months?

A I think I did.

Q And what was that document, sir?

A I don't remember that document.

Q Sir, did there come a time when you received a letter from Mr. McKay concerning the approval of Mrs. Murphy as a subordinated lender?

(Plaintiffs' Exhibit 99 was marked for identification)

A I see that there is such a letter here addressed to me. I don't remember it and I don't know whether I actually saw it.

MR. BEEBE: I offer that as the plaintiffs' next exhibit in evidence.

MR. BROOKS: No objection.

THE COURT: It may be received.

(Plaintiffs' Exhibit 99 was received in evidence)

MR. BEEBE: May I read that, sir?

THE COURT: Yes.

(Plaintiffs' Exhibit 99 in evidence was read to the jury)

Q There is reference to an earlier letter dated February 6, 1969, forwarding Mrs. Murphy's application. Do you recall recieving that February 6 letter?

A No.

Q I show you that letter, which is Exhibit 10 in evidence. It's addressed from McDonnell & Company to Mr. Etro in the division of finance.

I may have put that wrong. That may not be the letter and I will just drop that line of questioning for the moment.

Q Sir, did you have occasion to give conditional approval for subordination of -- for subordinated loans to McDonnell & Company in March 1969?

A I didn't understand what you said.

Q Are you familiar with conditional approval letters?

A Yes.

Q Did you have occasion to give a conditional approval to subordinated loans for McDonnell & Company in 1969?

A Probably. I remember stockholders more than subordinated lenders.

Q I show you a handwritten note from Mr. Schuette to yourself dated March 8, 1969, which we are marking as Plaintiffs' Exhibit 100.

(Plaintiffs' Exhibit 100 is marked for identification)

Q Do you recognize Mr. Schuette's signature on that, initials?

A Yes.

MR. BEEBE: I offer that as the plaintiffs next exhibit.

MR. BROOKS: Your Honor, I object. It doesn't show that it's related to McDonnell & Co.

Q Is that related to McDonnell & Co., do you recall from your deposition when there was questioning on this subject?

A I don't know.

Q If I made a representation that I believe it's related to McDonnell & Company, would that cross the hurdle?

A No.

Q I believe that all the documents produced to us, as has been represented many, many times, are related only to McDonnell & Co. Does that cross the hurdle?

A No.

THE COURT: Mr. Beebe, to save time why don't you go on to something else and then come back to this?

MR. BEEBE: Very well, your Honor.

Q I show you another memorandum conveniently headed "McDonnell & Co.," dated March 27, 1969, marked as Plaintiffs' Exhibit 101 for identification.

(Plaintiffs' Exhibit 101 was marked for identification)

Q Now, in March 1969 were there active discussions at the exchange concerning whether or not to put

McDonnell & Co. on restrictions?

A I know I testified some time earlier about some time in this period, but I can't remember now whether it was at this time or not. I don't recall at the moment.

Is there something in this memo about it?

MR. BEEBE: I'm offering this memo as the next plaintiffs' exhibit from the exchange files and on the very subject.

MR. BROOKS: I don't think that's sufficient foundation to introduce it at this time, your Honor,

MR. BEEBE: I believe it's a business record and has been admitted as such.

THE COURT: Business record with the stock exchange it's not. Now, is there some other basis for putting it in? This record is not made or kept by the New York Stock Exchange in the regular course of its business. It may not even be by McDonnell, or do we know?

MR. BEEBE: We know it comes from the New York Stock Exchange files.

THE COURT: That doesn't necessarily demonstrate it. On the other hand, is there any

question about its authenticity, accuracy or otherwi-e? Do we know who prepared it?

MR. BROOKS: No, we don't, your Honor. I believe it was found in the New York Stock Exchange's files but that's the best we could do. I don't recall any deposition witness identifying it. I don't see any name on it as the author. It could have come from McDonnell & Co.

MR. BEEBE: If this is, as I believe, Plaintiffs' Exhibit 58 from the depositions -- shall we do this at the side bar or right here?

THE COURT: Come to the side bar.

(At the side bar)

MR. BEEBE: The answer to this particular one is very simple, your Honor. Before the case started you may recall the very first time I got involved, I came down on a motion which was required to make a request to admit I believe under the rule 36 of the federal rules of civil procedure. I served it. This was one of the documents, 58.

There was a response and the admission, and I'm reading from the signed sworn admission:

"Admits plaintiffs' Exhibit 58 is a two-page copy of a document contained in the files of the

exchange and prepared by the exchange in the regular course of business."

I got the business record admission out of them already.

MR. BROOKS: I will agree to that, your Honor.

THE COURT: All right.

(In open court)

(In open court.)

THE COURT: It may be received.

(Plaintiffs' Exhibit 101 received in evidence.)

BY MR. BEEBE:

Q Now, sir, in regard to Exhibit 101, there is a statement:

"McKay reported that he has discussed" -- this is March, 1969 --

A Where is this?

Q At the very bottom of the page.

"McKay reported that he has discussed the dire consequences of being on restriction with McDonnell, and that such limitations would certainly harm the firm for many months to come."

But, sir, if you know were the dire consequences that McDonnell would suffer if placed on restriction?

A That seems to be Mr. McKay's words, not mine.

Q I know; I am asking you.

A I don't care to speculate on what Mr. McKay might have meant.

Q I am asking you your views of whether or not putting McDonnell & Company on restrictions would produce dire consequences?

THE COURT: No, I am going to sustain an objection

to that. We are dealing with this exhibit. If we are not dealing with this exhibit the question is objectionable in form.

Q Let me then come back to the exhibit, sir. Was it reported to you in the regular chain of reporting within your department on or shortly after March 27, 1969, that McKay had said there would be dire consequences in placing McDonnell on restrictions?

A I don't recall whether it was or not.

Q Now, sir, do you have Exhibit 100 for identification before you, the one that there was a question of whether it pertained to McDonnell or not?

A Yes.

Q Have you ever seen that memorandum before?

A I don't know.

Q At your deposition on page 248 when shown that memorandum you went a little further. Your answer was: "I don't recall it but probably."

Does that refresh your recollection that you probably saw it?

A No.

Q Your testimony two years ago was accurate, was it not, at that time, when you were under oath?

A To the best of my recollection at that time it was.

I don't recall anything about it now.

Was this shown to me then by itself or with other documents?

Q I believe by itself. It was marked Exhibit 53.

Could I ask another question about that: Was that memorandum referring to McDonnell's condition at the time?

A I don't know.

Q Your next testimony at your deposition, at page 248:

"Q Would you say that Mr. Schuette's remark that the firm needed capital is a true reflection of McDonnell's condition at that time?

"A Well, I don't have any specific reason to think so, but I imagine it's true from the stream of these things we have been looking at, it looks as though they were striving to either get down under 1,500 or to get a little lower below 1,500, whichever they were at the time."

A That doesn't sound illogical.

Q It sounds like this memo refers to McDonnell & Company, does it not, sir?

A Not necessarily. Those remarks you just read would have been logical whether or not this referred to McDonnell.

MR. BEEBE: I offer it again in evidence, page 248 --

MR. BROOKS: I object, your Honor.

THE COURT: Yes, objection sustained.

BY MR. BEEBE:

Q Did McDonnell & Company need capital in March, 1969?

A They needed excess capital.

Q In other words, it is your position they were in compliance with the net capital requirements at that time, sir?

A I believed that at the time.

Q Now moving to the weekend meeting to James McDonnell, sir, the meeting just before the Memorial Day weekend: do you recall that?

A What year?

Q 1969.

A Yes.

Q Just to set the scene, where did you meet with Mr. McDonnell, James McDonnell?

A At McDonnell & Company, I believe.

Q Had you ever met James McDonnell before then?

A No -- well, I don't think so.

Q Was it late in the afternoon?

A I think it was in the afternoon.

Q Did you say to Mr. McDonnell in words or substance that the exchange was going to shut down McDonnell & Company unless Mr. James McDonnell put in a million dollars?

A I don't recall that.

Q That is the kind of thing that would stick in your mind, wouldn't it?

A No, not necessarily.

Q You don't deny you said that, do you? You just don't recall one way or another?

A I just don't recall.

Q Do you recall whether or not Mr. James McDonnell put a million dollars into the company then or shortly thereafter?

A I think he did not.

Q And the exchange did not shut down McDonnell & Company shortly thereafter, did it?

A That is true.

Q You testified this morning about Flanagan Trust and how the exchange did not approve the funds in the Flanagan Trust as good capital, sir, do you recall that?

A Yes.

Q That was about February, I believe, 1969?

A I don't recall the date now.

Q I have Exhibit EE and Exhibit EE-1, dated March 6th to March 11, 1969 (handing).

I take it fromthe last paragraph of Exhibit EE, which I will read because we have only one copy, and I will read it:

"According to McKay, the firm's lawyers" --

MR. BROOKS: I have another copy of that here if it will make it easier for you.

MR. BEEBE: Why don't I read on while you are looking for it.

"According to McKay, the firm's lawyers were meeting with Fred Randolph to again discuss the exchange's objection to the trust agreement covering the$1,075,000 of potential capital. Had this agreement been approved in its initial form the firm would have had sufficient capital for the underwriting."

Q Now, my question is how long before March 6, 1969, had the exchange turned down this $1,075,000? Can you give us a time frame, sir?

A No, I can't. I am not even sure that it happened up to this date.

Q Well, it mentions in there the exchange's objection. When did the exchange's objection first occur?

A I don't remember that. The objection he is

referring to is with us raising the question back with the firm that this might not be an acceptable loan.

Q I understand that. I am just trying to find out how much before this March 6th this already had been apparently in a discussion stage. How long before that had the exchange voiced its objection?

A I don't recall that.

Q You testified that these funds, in any case, were replaced by Murray McDonnell borrowing a million dollars from a bank and then later on, at another point, $600,000.

Now, when was the million dollars borrowed by Murray McDonnell?

THE COURT: Isn't this a matter of letters that are already in the record? Do you go beyond that in this question, Mr. Beebe?

MR. BEEBE: No, sir. I don't--

THE COURT: Then you have made your record. Let's go on to another subject.

Q My question is, sir, the letters that I have indicated here are Exhibits PPP and QQQ, dated May 5th and May 19, 1969.

What did the New York Stock Exchange do between March 6, 1969, or whenever it was that it raised the objection and refused to accept the million dollars in

capital, and May 5th which is the earliest date with regard to the million dollars but weren't there?

A I don't recall what we did in the period. I don't know why we should have.

Q There was questioning this morning, sir, with regard to Exhibit 56A, and especially the attachment. I am going to ask you about the attachment which is the knowledgeability letter.

56A is a restriction letter, is it not, dated May 21, 1969?

A Yes.

Q What is the restrictive aspect of the knowledgeability letter which is required in that letter?

A There is none.

Q Does the presence of a knowledgeability letter or the requirement that a firm obtain a knowledgeability letter make it more difficult for the firm to raise capital?

A It might, but I would hope not.

Q How long before that date, that is, May 21, 1969, were knowledgeability letters required as a matter of practice by the New York Stock Exchange?

A They were not required as a matter of practice.

Q How long before that date were knowledgeability letters in use in any manner by the New York Stock Exchange?

A I don't recall but it would have been back at least into the mid'60s on occasion.

Q Was one purpose of the knowledgeability letters to assure the exchange that the firm involved had been cooperative in making information available to the capital contributor?

A Yes, that is what it says.

Q Was another purpose to place the contributor on notice that it could not hold the New York Stock Exchange responsible if something was wrong?

A Yes.

Q Were knowledeability letters used in situations where firms had special kinds of problems?

A Sometimes.

Q Were knowledgeability letters given to our clients?

A I don't believe so.

Q In 1968 and 1969 did the New York Stock Exchange enforce the net capital rule strictly?

MR. BROOKS: Your Honor, I object to the question.

THE COURT: Sustained.

Q Was the exchange staff under great pressure in that time to interpret the rule as loosely as possible so that firms would not be deemed in violation of the rule?

MR. BROOKS: Objected to.

THE COURT: Sustained.

Q Did you ever say that, sir?

A I know that I have been quoted as saying it.

THE COURT: That is not the question.

THE WITNESS: I don't know.

Q Did you say something like that?

A I don't know.

Q Who quoted you as saying that?

A I believe Hurd Baruch.

Q Was he the only person who quoted you as saying that?

A I believe so.

Q Did there come a time when a subcommittee of the United States Senate Committee on Banking, Housing and Urban Affairs ordered a study of the New York Stock Exchange's interpretation and enforcement of the net capital rule?

THE COURT: I think we better come to the side bar.

(At the side bar.)

THE COURT: Mr. Beebe, where are you going?

MR. BEEBE: Judge Owen, in the course of the history of all the events that occurred in 1968 and 1969 and later there came a time when the SEC and various congressional committees studied precisely the issue that is joined here--

MR. BROOKS: May I --

MR. BEEBE: May I finish my statement? It is very important.

THE COURT: I just don't want your statement to waft across to the jury box.

MR. BEEBE: We can adjourn to the robing room.

THE COURT: The trouble is we are running out of time. I want to take as little time for this as possible, consistent with due process.

MR. BEEBE: Right.

The point is, your Honor, that this man, Mr. Bishop, and his department and his exchange were thoroughly examined; he personally and the exchange itself on the very question here.

They can't gainsay that McDonnell wasn't part of that. Of course it was. They can't gainsay that memo which has been called at one point the capstone; since then it has been succeeded by other capstones; it was not an isolated incident. It was a very carefully prepared choreography by the exchange in attempt to justify what they did, what they did specifically with regard to McDonnell & Company.

The documents that were used --

THE COURT: But why are we getting into the senate report for?

MR. BEEBE: Coming to the senate report and the other reports -- I am focusing primarily on that one case study, your Honor -- were specifically directed to this issue of whether the McDonnell & Company's enforcement, the enforcement by the New York Stock Exchange, was in violation of the rules by bending the rules, or was not.

Yesterday I objected a number of times about the questions coming in about the SEC. I was overruled consistently --

MR. BROOKS: No --

MR. BEEBE: You cannot isolate those investigations that happened down in Washington when McDonnell was one of the big three and was, in fact, perhaps next to Blair the biggest of those three, that is precisely what was done here.

If they are going to say that McDonnell was not included in those investigations down there, let them prove it on their redirect. I submit that's exactly what the senate committee was studying, and if I can't get those in I would offer them by themselves.

MR. BROOKS: They have been ruled on.

MR. BEEBE: I offer them again.

THE COURT: I am not quite clear. You are saying I allowed in evidence SEC matters subsequent to the demise

of McDonnell? I understood I was ruling on SEC surveillance during the closing days here and during the closing year and no statements of opinion by the SEC as to this at all.

MR. BROOKS: That is correct.

MR. BEEBE: I think, your Honor, that is exactly the question here. I foresee an argument coming in --

THE COURT: I don't care what you foresee. The question is how do these become admissible, and for what purpose are you going after this witness with this? I am only going to rule on one question at a time. Are there things in there that you can use in normal contradiction of anything that this man has testified to, any inconsistencies in his testimony?

MR. BEEBE: Yes, that is exactly it.

Take the first question we have right here, he is not just quoted by Hurd Baruch; he is quoted in that study.

THE COURT: I know, but you asked him whether he ever made these statements, and the answer is "I don't know."

MR. BEEBE: I would contradict him and say he did make it.

THE COURT: He has admitted it is quoted, and that is farther than he would have had to have gone. That is sheer hearsay, and normally you would have to have

Baruch here to say "Yes, I heard him say it."

MR. BEEBE: That quote is not from Baruch.

MR. BROOKS: I think it is Baruch, and the reason it got into the study is Baruch put it in.

THE COURT: What is the question you are going to ask him?

MR. BEEBE: Well, I don't want to rehearse all my questions right here --

THE COURT: Well, you better do it because I am going to rule that anything based on these studies is out unless you show me how it is proper cross-examination. If you are going to say: Didn't this study find so and so and so and so --

MR. BEEBE: No, I am not going to ask that.

I will just pursue this as an example of the last question:

Was the exchange staff under great pressure to interpret the rule as loosely as possible?

THE COURT: That is so objectionable in form it makes my head swim.

MR. BEEBE: On cross-examination?

THE COURT: Yes. It means nothing. What kind of pressure? Who? It has no specificity whatsoever. What do you mean great pressure? Improper pressure?

Proper pressure? Economic pressure? Illegal or self-interest pressure? Who knows?

No, I wouldn't permit that.

You are saying that the report says they were under great pressure. That is their conclusion. That is the thing you are going to have to prove to this jury.

MR. BEEBE: In this particular example this man is quoted as having said that.

THE COURT: He says "I was quoted as saying it. I don't remember saying it."

MR. BEEBE: Then I wouldn't pursue it further.

THE COURT: Let's go to the next one.

MR. BEEBE: I don't have the next one with me. Let's assume it is a hypothetical and he denied --

THE COURT: Then you might be able to show him the report, mark it for identification, and ask him to read it and ask him if it refreshes his recollection, and if it does not refresh his recollection that is the end of it.

MR. BEEBE: Well, I will pursue that route, your Honor. I would submit--

THE COURT: You pursue whatever route you want. I won't rule on anything that is not before me. Then there is going to be a contention that there is something that

should be admitted that I didn't let in. All I am ruling on is that this type of thing, such as this last question, and this quotation that is attributed to him - I wouldn't let you put that in evidence through the study as being against him, because it is not a self-sponsoring document. It is a conclusion of a committee.

MR. BEEBE: I should have the study here. None of them am I putting in that are conclusions of the committee. All of them are of this nature, where a man is quoted as having said something and I have his transcript in Dempsey Tegler where he also testified.

THE COURT: Fine. Then you show it to him and ask him if he said that on some other occasion. That's another matter. You are not dealing with study any more. That's prior inconsistent testimony.

MR. BEEBE: There are certain cross references and I will pursue it along those lines.

THE COURT: All right.

(In open court)

BY MR. BEEBE:

Q Moving on to another area for just a moment. The income tax refund which you testified about this morning. you mentioned that one method of giving credit as good capital to a potential incometax refund was to have the lawyers from the firm or perhaps the lawyers from the stock exchange go up to Andover, Massachusetts, check to see if it was around the corner, do you remember thatline of testimony this morning?

A Yes.

Q In the case of McDonnell & Company did any

lawyers go up to Andover, Massachusetts?

A I don't remember that.

Q Now, we have marked for identification previously a memorandum as 63, which is the trial identification number, on this subject, and I would offer that in evidence at this point.

MR. BROOKS: We don't seem to have a copy of that.

MR. BEEBE: I don't have any other copies myself.

Shall I show you this one?

MR. BROOKS: Any one.

(Pause)

MR. BROOKS: Your Honor, I don't deny that the document is genuine and is in the files of the New York Stock Exchange. I don't see there is a foundation for it for production through this witness.

THE COURT: I will receive it. Overruled.

(Plaintiffs' Exhibit 63 was received in evidence)

Q Sir, in reviewing that do you know of any information outside of that memorandum, whether in written or oral form, concerning the status of the McDonnell & Company claim for a refund as of that date,

which I believe is August 1969.

A August 27, 1969. I can't pinpoint that time.

Q Sir, you testified about the sale of the advisory company, McDonnell & Company, and Exhibit RRR was marked in evidence.

(Pause)

That is a letter dated July 24, 1969, signed by these various people from Scheinman, Hochstein & Trotta and McDonnell & Company, which you testified about earlier.

Did that transaction, as it's set forth in the July 24th letter, take place, sir, or did a different transaction take place later as you testified this morning?

A As I said this morning, I can't remember.

Q There is reference in there to subordination by Scheinman of $625,000, subordination loan to McDonnell & Company "on terms acceptable to Scheinman and the New York Stock Exchange."

Did Scheinman actually make a loan to McDonnell & Company subsequent to that?

A That's the same question. I can't remember.

Q Exhibit 59 has been marked in evidence, and on the third page -- I believe this is a Newman memo --

it states --

A What's the date?

Q July 31, 1969, about seven days after that one.

"However, Mr. Scheinman feels that there could not be a takeover until McDonnell & Co. has had its audit and in his opinion that even if the audit was to start today, McDonnell would run out of money before the audit was completed."

A Takeover what?

Q McDonnell & Company or perhaps the fund, the management fund.

A I can't answer a question if I don't know which it was.

THE COURT: Are you going to be lone on this subject?

MR. BEEBE: No, very short.

THE COURT: When you are through with this subject we will recess.

MR. BEEBE: Yes, sir.

A Well, they are talking about merger or Scheinman clearing for McDonnell.

Q The last page though which you now have in front of you is talking about the merger, is it not?

A It sounds that way, although maybe even the clearing could be considered a takeover.

Q What I'm directing particularly my last question to you today is that sentence:

"It was his opinion that even if the audit was to start today, McDonnell would run out of money before the audit was completed."

Did you receive any information along those lines the end of July 1969 that McDonnell & Company would run out of money before the time it took to complete an audit?

A I don't recall having done so.

MR. BEEBE: That's the end of that particular line.

THE COURT: Ladies and gentlemen, we will be in recess until 10 o'clock on Monday morning.

(Jury leaves courtroom)

(In the robing room; juror No. 4 present)

THE COURT: I want to chat with you. I noticed throughout this trial you have had a lot of trouble staying awake.

JUROR NO. 4: It's on account because I work nights. Last night I had a lot of disturbance in my house and I didn't go to bed until about 5 o'clock

this morning.

THE COURT: Well, I'll tell you, the problem is, as you are aware, there is a lot of money that's in the balance here and these are very, very complicated issues that these lawyers have been raising for you on the jury to consider and I'm just concerned without your having heard all of the evidence, because I have noticed unhappily from time to time you just can't stay awake. Am I right about that?

JUROR NO. 4: I doze off because I haven't had sleep. My eyes just close.

THE COURT: Well, I fear that I don't think you are going to be able to participate in this because I think you have missed a little too much of it.

I want to say this kindly to you, but I think it would be fairer to the parties and to the jury if I excused you.

JUROR NO. 4: Yes.

THE COURT: Would you understand if I did that?

JUROR NO. 4: I understand, Judge.

THE COURT: I know you have been with these people and you would want to finish with them, but I have a feeling that you haven't been with enough of

this trial to make it fair to the lawyers and to the people who are going to be relying on you.

JUROR NO. 4: I wouldn't want to hurt anybody's feelings.

THE COURT: It isn't a questionof anybody's feelings but I have a job as a judge to see that each member of the jury is as knowledgeable as can be in order to give a fair result here.

JUROR NO. 4: I understand that, Judge.

THE COURT: I have a feeling that you have been working nights.

JUROR NO. 4: I have been working since this trial has been going on.

THE COURT: I gather you do understand the problem I have and that you would understand that if I did excuse you from further service.

JUROR NO. 4: Yes.

THE COURT: Because I hink I must do that; all right?

JUROR NO. 4: Yes.

THE COURT: I'll tell you what you might want to do, if you want to keep in touch with these people and find out how things go, I'm sure they would be glad to tell you.

JUROR NO. 4: I understand you very clearly, your Honor.

THE COURT: I'm sorry I have to do this, but I just feel as the trial judge the issues that are to be raised, it's inappropriate for you to stay because I think you missed too much.

JUROR NO. 4: Yes, I understand you very good.

THE COURT: Well, thanks very much. I'm sure Mr. Dorsa will take care of the balance of the formalities of service and whatever.

(Adjourned to May 19, 1975 at 10:00 a.m.)